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IN THE

Supreme Court of the United States

October Term 1969

Nos. 914, 915, 916, 917, 920, 921, 1038, 1057

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE, MANUFACTURERS HANOVER TRUST COMPANY, as Trustee of the First and Refunding Mortgage of the New York, New Haven and Hartford Railroad Company, and THE CHASE MANHATTAN BANK, N.A., as Trustee under the General Income Mortgage of the New York, New Haven and Hartford Railroad Company,

Appellants-Petitioners-Respondents,

—v.—

UNITED STATES OF AMERICA, INTERSTATE COMMERCE COMMISSION and PENN CENTRAL COMPANY,

Appellees-Respondents-Petitioners.

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

JOINT REPLY BRIEF ON BEHALF OF THE FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE AND MANUFACTURERS HANOVER TRUST COMPANY, AS TRUSTEE, ETC., APPELLANTS-PETITIONERS-RESPONDENTS

Statement

This reply brief is submitted on behalf of The New York, New Haven and Hartford Railroad Company First Mortgage 4% Bondholders Committee ("Committee") and Manufacturers Hanover Trust Company, as Trustee of The First and Refunding Mortgage of The New York, New Haven and Hartford Railroad Company ("Manufacturers Hanover") in response to the answering briefs served by the United States, Penn Central and the States of New York and Connecticut.

POINT I

The Government and Penn Central Have Failed to Show That the New Haven Bondholders Sought Inclusion Rather Than Liquidation as Volunteers; They Were Compelled in the Public Interest to Continue Operations at Enormous Losses Until Penn Central Was Ready to Purchase the New Haven; to Charge Them in Addition for "Abandonment Delay" Is to Duplicate Their Burdens.

While we agree with the Government (Govt. Br., pp. 30-31)* that no issue remains that the applicable standard of valuation in this case under the Constitution and the statutes is liquidation value, we do not regard this as disposing of the constitutional question. It is the bondholders' position that although the Commission purported to make its computations under a liquidation value standard, it in fact did not apply such a standard and did not in fact

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* The brief for the United States and Interstate Commerce Commission is hereafter referred to as "Govt. Br."; the brief for Penn Central Company is hereafter referred to as "PC Br."; the brief of the State of New York is hereafter referred to as "NY Br."; the brief of the State of Connecticut is hereafter referred to as "Conn. Br."; the bondholders' main briefs are hereafter referred to as "Man. Br.", "Committee Br." and "Chase Br.".

award liquidation value. Thus, constitutional and statutory issues—not limited to the form of words, but encompassing the content and meaning of liquidation value—not only remain in this case, but are of paramount importance to its determination.

Neither do we agree with Penn Central's suggestion (PC Br., p. 27) that the constitutional tests which this Court enunciated in *Brooks-Scanlon Co.* v. *Railroad Commission,* 251 U.S. 396 (1920), are satisfied in the case of a hopelessly deficit railroad as long as the Commission assumes that a certificate of abandonment will "ultimately" issue, however long it delays that eventuality. If, as in this case, the railroad has been compelled in the public interest to continue to operate at enormous loss for many years so as to be available for transfer to the merging companies,* the Commission may then add the cost of a further year's hypothetical delay, we submit that the doctrine of *Brooks-Scanlon* has been emasculated. What the Commission has done, in adding the abandonment delay hypothesis, is simply to charge the New Haven for both branches of the dilemma in which it was placed—first compelling the New Haven to continue operating for seven years at enormous losses until Penn Central was ready to acquire it and then—when transfer finally occurred, adding to that burden the hypothetical consequences of what would have happened if the sale had failed to take place and, as of December 31, 1968, the New Haven were forced to liquidate.

The Government (Govt. Br., p. 28) reiterates the Commission's claim that in its Remand Report, it was entitled to reduce the liquidation value as found in the Inclusion Report (corrected by the Remand Report) because, in the Commission's words:

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* The New Haven was not merged into Penn Central. Its properties were transferred at a price. It retained all of its liabilities. A merger is not accomplished simply because property is purchased for securities and cash.

> "In the inclusion report we found that the consideration Penn Central had agreed to pay would equal liquidation value there shown and that made it unnecessary for us to explore other pricing considerations. The liquidation value that results in this reopened proceeding exceeds the agreed price, obliging us to make a new determination as to whether the price resulting from such a valuation is fair." (334 I.C.C. at 54, App. 141a)*

But this explanation is belied by the Commission's own statements in its Inclusion Report. It there noted that it had an obligation to determine liquidation value independently of the parties' agreement:

> "The financial terms arrived at here under Section 5(2)(d) will also constitute the comparable terms under Section 77 of the Bankruptcy Act. And under that act *the Commission must exercise its independent judgment notwithstanding the fact that the agreement has been reached.* Accordingly, while the agreement carries some probative force as to the values of the properties involved, it is by no means controlling. . . ." (331 I.C.C. at 657, App. 15a)** (emphasis added).

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* References to the Appendix of Decisions will be identified hereafter by the abbreviation "App." preceding the page numbers, which are identified by the letter "a". The abbreviation "Rec." refers to the Record Appendix identified by the letter "c" after the page reference.

** The Agreement at any event was not evidence of the New Haven's value since the real parties in interest on the New Haven side, namely, the bondholders, were excluded from the negotiations and never consented to the agreement, as, in fact, they have not done yet. See also *In re The New York, New Haven and Hartford Railroad,* 147 F.2d 40, 49 (2d Cir. 1945), *cert. denied,* 325 U.S. 884 (1945), where the Second Circuit held that under Section 77, the Commission is required to make an independent determination of fairness.

It consequently concluded:

> "Based on our own judgment after analyzing and interpreting the entire record, we find that the liquidation value of the NH assets to be conveyed to Penn Central is about $125 million as of December 31, 1966." (331 I.C.C. at 688, App. 46a)

The Commission also declared that it had an independent obligation to assure, for the public interest, that Penn Central was paying no more than a fair and reasonable price. It therefore had to determine what liquidation value was, and had to make this determination independently of the parties' agreement. The Commission purported to do this in its Inclusion Report (331 I.C.C. at 688, 697, App. 46a, 55a)* and when it now makes further deductions from liquidation value, it is actually arriving at a figure which is below liquidation value and therefore in violation of the New Haven's constitutional rights.

In its brief, Penn Central argues (PC Br., pp. 29-30) that the bondholders were volunteers seeking inclusion. This disregards the posture of the proceedings. Once the Reorganization Trustees filed a petition, in early 1962, looking toward Penn Central's take over of the New Haven lines, the New Haven bondholders had no practical choices except to submit to a sale to Penn Central or have the New Haven operations grind on, at ever mounting losses, until it finally ran out of cash and exhausted their equity. In spite of Penn Central's suggestions to the contrary (PC Br., pp. 29-35), the Commission itself was perfectly frank in admitting that "if the [Reorganization] trustees had pre-

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* There can be no other explanation for the Commission's consideration of the alleged "cost" of the acquisition to Penn Central, except an effort to disregard the agreement and measure fairness to Penn Central in terms of its cost against the value of what it receives. (Cf. 331 I.C.C. at 692-97, App. 50-55a)

sented abandonment applications as an alternative to a sale to Penn Central,

> "the Commission would almost certainly have deferred their consideration for a reasonable period while inclusion was being explored." (334 I.C.C. at 59, App. 146a)*

The New Haven bondholders had to accept the sale of their property, on terms which were to be fixed and approved by the Commission and the courts as fair and

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* The Commission's course of conduct in denying the New Haven meaningful relief from its passenger deficits (in the *Train Discontinuance Case*, 327 I.C.C. 151) affords convincing support for this admission, as does the dismissal by the Reorganization Court of the Committee's petition to terminate the reorganization and liquidate in view of this Court's decision in approving the Penn Central merger. While the Government now argues that the *Train Discontinuance Case* was somehow independent of its decision to require inclusion of the New Haven passenger, as well as freight service, in the merged Penn Central, the two decisions were announced simultaneously and refer to each other.

While Penn Central now portrays itself (PC Br., p. 30) as a reluctant purchaser of the New Haven, the fact is that it commenced negotiations with the Reorganization Trustees as early as June, 1964 and reached substantial agreement on the terms of sale in November, 1964. Nor does it deny the fact that, in so doing, it was motivated by the fact that "inclusion might be a necessary condition to approval of the merger" (PC Br., p. 30). The New Haven bondholders, as distinct from the Reorganization Trustees, had no part in any of these negotiations, and the Reorganization Court rejected the agreement when it was finally presented for review.

Penn Central's reference (PC Br., p. 30) to *St. Joe Paper Co.* v. *Atlantic Coast Line R.R.*, 347 U.S. 298 (1954), cannot support its point. If the bondholders are deemed to be (as they seem) the owners of the New Haven's equity, they have never consented to the sale in the sense contemplated by *St. Joe Paper*. Thus, the transfer of the New Haven to Penn Central must find its validation from a source other than that considered in *St. Joe Paper*. The Reorganization Trustees and the Commission justified the step on the basis of the fact that the New Haven was a "wasting asset," relying on *In re V. Loewer's Gambrinus Brewery Co. Inc.*, 141 F.2d 747 (2d Cir. 1944) (331 I.C.C. at 722, App. 80a; *cf. Penn-Central Merger Cases*, 389 U.S. 486, 552 n. 4 (1968)).

equitable, and in the meantime had to continue indefinitely on a course which steadily eroded their equity through the mounting of administrative expenses—a process which left the railroad, at the time of transfer, subject to administration claims which had risen to more than $70 million. (Cf. 334 I.C.C. at 95, App. 182a)

Thus, the posture of the New Haven bondholders was not that of volunteers seeking inclusion as preferable to the course of prompt liquidation, but that of private persons compelled in the public interest to continue to sustain enormous losses for many years until a solution was devised that insured continued rail service in New England.

In this context, we submit, it is grossly unfair to duplicate burdens which the New Haven has been forced to sustain in the public interest by adding a further loss for hypothetical delay. Penn Central goes far to admit the duplication. In the second footnote to p. 28 of its brief, it attempts to place the hypothetical abandonment delay in time, assuming first that it occurred in the year 1967 and then assuming that it occurred in the year 1968. In each case, however, the effect is to add to the enormous actual losses and actual expenses which the New Haven incurred in 1967 and 1968 hypothetical expenses of the same kind for those same years.* What, in fact, the abandon-

* The problem is well-illustrated by Penn Central's contention (PC Br., pp. 42-43) that the bondholders are not entitled to receive any share of Grand Central Terminal income for the year during which hypothetically abandonment is to occur because that would involve a duplication of the New Haven's income for the year 1967 or 1968. But the fact is that in any year in which abandonment delay hypothetically could occur, there would be Grand Central Terminal income to the New Haven in that same year. As we discuss below, if Penn Central is right that the New Haven should receive no credit for income in that year because it has already received it, it follows inexorably that the New Haven cannot be charged with expenses for that year since it has already incurred them.

ment delay theory does is to extend the New Haven's losses beyond the date of inclusion, and in effect require the New Haven to subsidize Penn Central in the amount of $16 million.

The Government (Govt. Br., pp. 35-38) takes a different tack, arguing that the New Haven could not have obtained an abandonment certificate until at least January 1, 1968, in view of the Reorganization Court's comments on the cash position of the New Haven and in view of the bondholders' evidence that the New Haven could have been reconstituted as a modern freight-only railroad and could make a profit in 1964 and 1965 if it had been modernized at that time.

The Government's reference (Govt. Br., p. 38) to the comments of the Reorganization Court that the New Haven's *cash* position had improved in 1967, misses the point which the Commission itself had recognized (331 I.C.C. at 703-04, fn. 33, App. 61-62a).* In 1967, as in past years, the New Haven was deferring payments of taxes, tort claims and per diem expenses. It was in default for both principal and interest on all of its pre-reorganization debt. In short, it was living off its bondholders' equity. The cash situation was a wholly different question from the fact of the erosion of the New Haven's net assets, as the Reorganization Court certainly knew.

The Government's reliance on the Reorganization Court's finding that there would be an unconstitutional taking if the New Haven were required to keep going after December 31, 1968, similarly misses the Reorganization Court's point. At the time of that decision the court understood that the assets of the New Haven would be

* As the Commission noted, the New Haven's *cash* losses in 1967 were $6,660,000, after extraordinary income of over $2 million (334 I.C.C. at 72, 73, App. 159-160a).

valued on the basis of a liquidation value as of December 31, 1966, assuming liquidation were to commence immediately without delays for abandonment proceedings (304 F. Supp. at 798, 799, App. 280a, 305a). Moreover, what the court was there discussing was the proposition that after December 31, 1968, not even the fact that the New Haven would ultimately be acquired by the already-merged Penn Central could justify continued erosion.* This is quite a different question from that which is pertinent here, namely, at what point in time the bondholders would have been entitled to liquidate the railroad if acquisition by Penn Central were not in the offing.

The Government's reliance upon the existence of the Mortgage Trustees' freight-only study seems likewise misplaced, for a similar reason.** What the Mortgage Trustees' study showed was another of the courses which the New

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* As we discuss at pages 69-71, *infra*.

** Actually, there were three freight-only analyses in the evidence. The first freight-only study was one made for the New Haven Trustees which showed that if the New Haven had been reconstituted as a purely freight railroad, it would have had a deficit in net railway operating income of over $4 million in 1965 (as opposed to an actual freight deficit in 1965 of about $7.5 million), which would have increased to over $7.5 million by 1970 (NHI-60, p. 8); Penn Central introduced evidence that, even after inclusion and taking advantage of operating savings resulting from the inclusion of the New Haven in Penn Central, the New Haven freight service would be a detriment to Penn Central by about $8.5 million per year (NHI-71, p. 8). In response to that evidence and in order to support their position that the New Haven, as a going concern, could be valuable to Penn Central, the Mortgage Trustees introduced (the Committee did not participate in this offer) a study made by Mr. Wyer, which concluded that if the New Haven had previously been reconstituted as a modern freight-only railroad, the reconstituted New Haven would have had net railway operating income of $4.8 million in 1965, after an expenditure of $38.5 million to be derived primarily from the sale of property used in passenger service, and net income of $12 million if it were owned by Penn Central. Mr. Wyer testified that his study could not be projected beyond 1965, and indeed

Haven might have followed if it had been in a position to terminate passenger service several years before 1965 and had been able to expend the receipts from the liquidation of its passenger-directed properties to rebuild itself as a freight-only railroad, and what Penn Central, with its enormous resources, would be able to do to improve the efficiency of the New Haven after it acquired the railroad. The fact that such a study was possible—and showed that the New Haven might have had favorable results if, on the basis of prior events, it had been able to operate in the manner envisaged in 1965—was used to support the bondholders' contention that the New Haven was entitled to "going concern" value, but it would seem to have little bearing on the course of an abandonment application to terminate the railroad service of the line as it actually existed, namely, as a gravely deficit-ridden freight and passenger railroad. Penn Central's own evidence showed that the New Haven's deficits for the years from the beginning of reorganization through 1965 were as follows:

Year	*Deficit in Net Railway Operating Income*	*Deficit in Net Income*
1961	$19,577,295	$19,549,689
1962	11,514,438	12,741,495
1963	10,090,136	12,264,275
1964	17,056,262	15,262,688
1965	16,007,664	15,063,389

(NHI-71, p. 7)

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subsequent evidence showed that at least after 1967, it was doubtful that a freight-only railroad could continue to obtain mail and express traffic, which represented over $2 million of the $4.8 million net railway operating income that Mr. Wyer took into account. As the Government noted, the Commission found this study "of dubious value inasmuch as it was not projected beyond 1965" (331 I.C.C. at 659, App. 17a). The Commission went further; it wrote: "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power *nor the prospect of earning power.*" (331 I.C.C. at 687, App. 45a) (emphasis added)

The Reorganization Court noted that the New Haven's deficits had persisted since 1957 and continued through 1968. (289 F.Supp. at 455, 458, App. 243-44a, 259a).

Moreover, the Government's position wholly fails to meet the problem that, assuming an abandonment proceeding would have been processed in 1967, the effect of the Commission's abandonment delay hypothesis is to duplicate expenses the New Haven actually incurred in 1967. In fact, the alternate analysis set forth at pages 48-51 of its brief compels that conclusion.*

Penn Central and the Government Have Failed to Meet the Bondholders' Argument That the Computation of the Effect of the Hypothetical One-Year Delay Is Grossly in Error.

The Government's discussion of the effect in terms of cost of a one-year delay (Govt. Br., pp. 43-48) is replete with errors of fact and misconceptions of law. Footnote 78 of the Government's brief (p. 45) takes issue with the fact, shown by NHI-45, p. 1, that the New Haven sold about $3 million of real estate in each year. The figures it cites are real estate *profits*. Thus, NHI-45, p. 1 shows that in 1965 the New Haven sold $5,091,170 of real estate, not $1,922,518, as the Government seems to suggest. In fact, Penn Central assumed that the New Haven could sell $3 million worth of real estate in each year that abandonment was pending (Rec. 351c, 353c).** The Government (Govt. Br., p. 45) and Penn Central (PC Br., p. 39) suggest

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* The specific points made on these pages about "offsets", *i.e.*, reductions in liquidation value which the Commission decided not to make, and some of which were never even suggested to it, are an aggravated form of the error this Court condemned in *SEC* v. *Chenery*, 318 U.S. 80, 94 (1943).

** While the Government is correct (Govt. Br., p. 45, fn. 80) that this evidence was excluded on motion of the bondholders, the statements of Penn Central's counsel nevertheless constitute admissions against Penn Central's interest.

that if significant segments of the railroad were non-operating the New Haven Trustees would have sold them already to raise operating cash. The Government fails to deal with the point which the Committee noted in its initial brief (p. 78), that the New Haven Trustees could not have obtained cash for operating purposes by selling non-operating property because they were required to deposit any such payments in the registry of the Reorganization Court since the property was subject to mortgage liens.

The Government next urges (Govt. Br., pp. 45-46) that the "non-operating" properties are primarily investments in affiliates or leased railroad lines which might not be saleable and even suggests that § 77(c)(6) of the Bankruptcy Act may prevent their sale before leave to abandon is obtained. Here again, the Government's contention contradicts Penn Central's assumption (Rec. 352c) that at least $9 million worth of investments could probably be disposed of within one year; none of that block of investments involves leased lines (cf. Rec. 352c). Moreover, the Government cites no authority for the proposition that § 77(c)(6) of the Bankruptcy Act relates to stock and debt of other railroads. The "investments" shown in NHI-42, p. 8, which are valued at over $20 million, all relate to stock ownership or debt of other companies; the New Haven's leases of other railroads are separately treated.

While the Government (Govt. Br. p. 47) contests the Committee's argument that the New Haven could sell off everything but the "line of railroad," it cites no authority for its assertion as to the New Haven's "minimum statutory obligation" and its own discussion of *Zirn* v. *Hanover Bank,* 215 F.2d 63 (2d Cir. 1954) clearly establishes that the equipment security holders would be entitled to repossess rolling stock in the event the New Haven defaulted.

On the question of preservation costs, the Government attempts to expand the evidentiary value of an exhibit

plainly identified as an estimate of the "costs of a *temporary* cessation . . . with *no liquidation* of properties" (Rec. 374-75c, emphasis added) on the basis of a descriptive statement by counsel at the pre-hearing conference (which took place eight days before the exhibit was prepared) and a quote from the prepared testimony of Trustee Smith. It is difficult to see how these statements cure the deficiency in the use of this exhibit by the Commission for a purpose for which the exhibit was not intended and for which it was not offered in evidence.*

Penn Central essentially reiterates the bulk of the Government's argument, but adds certain points which require additional comment.

As we have noted previously, Penn Central attempts (PC Br. pp. 42-43) to defend the failure of the Commission to award the New Haven anything for the income it would have received from Grand Central Terminal during the hypothetical liquidation period on the basis that such income has been credited already for the years 1967 and

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* Responding to the point that the exhibit was incompetent hearsay if it was used for the purpose to which the Commission put it, the Government contends that "the exhibit was admitted by the Examiner for whatever purpose it might serve" (Govt. Br., p. 46, fn. 82). The only statement by the Examiner which appears in the transcript is the comment "I am satisfied it is admissible and R-43 is received in evidence." (Rec. 382c). There is no indication that the Examiner took the document for any purpose other than that stated by counsel who offered it, namely, "Actually, it goes to the Trustees' position as to what is required because whether or not Mr. Bader is right, this is on what the Trustees are relying in making their plans." (*Id.*) No one commented when the objection to its admissibility was withdrawn on that basis. (Rec. 382c) It is we submit, an elementary principle of evidence that where an exhibit is competent for one purpose but inadmissible for a second, counsel are entitled to have its use limited to the purpose for which it is offered. Cf. McCormick, *Evidence* § 59 (1st ed. 1954).

1968. Assuming there is merit in this point, however, then it must similarly follow that the Commission had no right to charge the New Haven for the expenses it had already incurred. Plainly, the New Haven has already become indebted for 1967 and 1968 taxes; it has sustained its employee costs, purchased supplies, in short, paid virtually all the so-called "Temporary Costs" enumerated in Exhibit R-43 (Rec. 374-75c) in 1967 and 1968. Thus, if Penn Central is correct, the Commission has no warrant to charge the New Haven with at least $7.5 million that it has asserted are the costs of a hypothetical delay in abandonment. If, on the other hand, Penn Central is not correct, the Commission's computation is plainly erroneous because it fails to give credit for the income the New Haven would receive in the period of delay.

Penn Central further misconceives the record on the New Haven's rental income (PC Br., p. 43). The characterization of the New Haven's rental income as a "wasting asset" simply refers to the fact that the New Haven is assumed to be selling off the property from which it obtains rent (Rec. 115c). If sale of the property were delayed for one year, then the New Haven would have obtained the rental income from all of the property—which the evidence shows is $1 million in the first year after railroad operations cease (Rec. 115c).

Neither Penn Central nor the Government makes any reply to the point made in the initial brief of the Committee (pp. 79-80) that if, as the Commission now assumes, the period between the stoppage of the railroad and the completion of liquidation would be seven rather than six years, there is no evidentiary basis for reducing the value of the real estate by $8.1 million for distress sales in the fifth and sixth years of liquidation.

POINT II

The Government and Penn Central Fail to Show the Commission's "Bulk Sale Discount" Was Predicated on any Theory Other Than the Discredited Theory That the Commission Had the Power to Condition an Abandonment Certificate on a Sale in Bulk, and Therefore, at a Bulk Sale Price. No Proper Justification for Adopting a Bulk Sale Price Liquidation Method Is Presented.

The briefs of the Government and Penn Central are written in support of the opinion of the majority of the Statutory District Court and not of the Commission's Remand Report. By implication it is admitted the Remand Report was in error.

The majority opinion was likewise in error, misconstruing the Remand Report in the matter of the "bulk sale discount." The majority asserts the Commission must be sustained because, in accepting Simon's "bulk sale discount,"* the Commission merely recognized that the discount corrected its neglect of certain risks described by Simon and the impact of the New Haven's liquidation on New England real estate values pointed to by the majority (305 F. Supp. at 1059, App. 417a).

The majority misread the Remand Report. The Commission recognized that the New Haven had several

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* The testimony as to the 15% return was provided by Penn Central's witness Simon, who suggested that a buyer of the property in bulk would pay for the property partly with his own funds (25% of the purchase price) and partly with borrowed funds (75% of the purchase price). He testified the going rate for mortgage money on unimproved land was 9% in 1966. The combination of a 15% return on 25% and 9% on 75% led to a 10.5% composite rate which the Commission employed to arrive at its computation of the $6.69 million discount. The New Haven property consisted of improved and unimproved land but the Commission applied the 10.5% rate to all the realty.

ways open to it for liquidation. One was to sell its property in parcels over a six-year period according to appraisals the Commission characterized as "conservative". (331 I.C.C. at 664, App. 22a) The other was to sell immediately to a bulk buyer who would require a return of 15% per year on his investment.

The Commission recognized the first method would yield $6.69 million more than the second and would be the method a *non-railroad property owner* would pursue. It rejected the first method solely because it considered the Commission's power to compel a railroad not to break up its property and take it out of railroad use rendered the better method of liquidation unavailable to the New Haven.

In the Remand Report the Commission must be understood to have said in effect: "if the New Haven—a railroad company—may liquidate on the best method which is available to a non-railroad company, the net liquidation value of its properties is $162.7 million less $15.4 million for abandonment delays we predicate, or $147.3 million. If we are correct that our power to condition an abandonment certificate on sales to a single buyer for continued railroad use carries with it by necessary implication the power to compel liquidation at a bulk price, then the bulk buyer will pay $6.69 million less and the estate will realize only $140.6 million."

The Courts unanimously declared the Commission did not have the power it claimed. The right to discontinue deficit rail operations implies the right to net salvage value, which means liquidation by the best available means. (304 F. Supp. at 805-6, App. 293a, 305 F. Supp. at 1059, App. 417a.) This holding logically eliminates the "bulk sale discount."

To save the "bulk sale discount" the Government and Penn Central briefs argue:

1. The majority correctly construed the Remand Reports; (Govt. Br. p. 54; PC Br. p. 50) and

2. Even if the majority misconstrued the Remand Report, Simon's method of valuation is a recognized method of valuation and yields a fair result because it accounts for risks overlooked by the Commission. (PC Br., pp. 53-58; Govt. Br. pp. 58-59).

A short answer to the first proposition is that Penn Central tried to persuade the Commission to construe Simon's testimony as the majority did and the Commission refused.

In the Remand Report, the Commission defined its rationale:

> "Penn Central here argues, in effect, that we need not consider whether we can limit the right to break up the property.
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> • • •
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> "But Penn Central's analysis overlooks what is necessarily the bondholders' position—namely that aside from principles of equity and fairness they have a fixed right to sell off NH in parcels, so that even a bulk buyer must pay the per-parcel price. *Our answer is that we may compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price.*" (334 I.C.C. at 61; App. 148a) (Emphasis added)

Since all four judges rejected the notion that an abandonment certificate could be conditioned upon the sale at a price less than the fair market value of the property, the Government has been at pains to assert that the Commission's rationale for the deduction did not rest upon its power to compel a bulk sale. The Government argues:

> "The Commission's rationale for the deduction was two-fold. First it agreed with Penn Central that such

> a deduction gave the bondholders 'the full economic equivalent of the liquidation value of the assets' in that such a deduction 'reflects a market appraisal of the risks that the estate avoids, and the bulk buyer assumes'. Second, going beyond that position, in findings that were completely independent, the Commission further stated that in an appropriate case it could 'compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price', in order to attract a bulk buyer for continued operation of the railroad on the basis of a fair market price and to preserve the railroad as a going concern." (Govt. Br. pp. 53-54)

The Commission's own analysis of the basis for the bulk sale discount was not two-fold. The Commission derived the "economic equivalent" from the alleged servitude—the inability to withdraw the property from railroad operations if a buyer would buy the bulk and continue the operations.

Although the Government has improperly charged the Reorganization Court with substituting its opinion for that of the Commission, (Govt. Br., p. 57) in fact it was the majority of the Statutory District Court which substituted its opinion for that of the Commission. It was the majority which said that in its opinion the Commission gave an insufficient weight to risk factors and uncertainties in liquidation. (305 F. Supp. at 1059; App. 417a-418a) The majority sought to substitute its judgment as to the soundness of the Commission's decision that six years was a proper liquidation period. The majority sought to substitute its opinion that greater weight should have been given to the impairment of New Haven's real estate upon the cessation of New Haven operations. The majority sought to impose its opinion that an underwriter's discount could properly

have been deducted by the Commission. (305 F. Supp. at 1059; App. 418a).

The Government is, therefore, compelled to assert:

> "The Commission adopted Simon's deduction that the market would make for the unpriced risks of a six year liquidation of the New Haven . . ." (Govt. Br., p. 58)

In fact, the record shows plainly that the Commission merely accepted Simon's statement that a bulk buyer would require a 15% return on invested capital.* With respect to the initial valuation of the real estate, Penn Central's witness had urged the risks and uncertainties, had argued against a six-year liquidation and for a ten-year liquidation period and had urged a 7% discount rate instead of a 6% discount rate. (NHI-92, pp. 13-14) But the Commission had said:

> "In discounting the anticipated liquidation proceeds to present worth, the NH trustees used a discount rate of 6 percent based on a 6-year liquidation period. Penn-Central considered a 6-percent rate too low in view of the risks and uncertainties involved in the liquidation and applied a rate of 7 percent based on a 10-year period.
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> "The record supports the 6-percent rate applied by the NH trustees. The valuation of the assets themselves are sufficiently conservative so that, when weighed with other pertinent considerations, they offset the factors which moved Penn-Central to urge a higher rate." (331 I.C.C. at 664; App. 22a)**

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* The Commission said: In our view its evidence [Simon's testimony] shows that the bulk sale buyer must receive a minimum return on his investment, or he will not buy." (334 I.C.C. at 62, App. 149a). The Commission clearly meant "on the purchase price" and not "on his investment."

** In urging the Commission to apply the 7% discount rate, Penn Central's witness Hull enumerated the following "risks and uncer-

The Commission never changed its valuation or made adjustments for risks.

Penn Central also denies that the Commission relied upon its power to compel a bulk sale (PC Br. pp. 44-45) and scours the record for support for the findings made by the majority of the Statutory District Court. But the question is not whether the record can be culled to support findings which the Commission did not make but were made by the majority. The question is whether the valuation which the Commission made on substantial evidence could be properly diminished for a discount based on the Commission's claimed power to compel a bulk sale.

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tainties involved in the liquidation": "(1) Fluctuations in the market prices for unsaleable items such as rolling stock and relay rails; (2) Fluctuations in the market prices for steel, copper and other forms of scrap; (3) Human error in estimating quantities of property available for sale—for example, the quantity of relay track which the New Haven will produce; (4) Fluctuations in the market price of land; miscalculations as to the possible price impact of placing large amounts of land on the market; and various other factors—some of which will be covered by Mr. John R. White in his testimony; (5) Taking of land by eminent domain, with possible inadequate awards; (6) Destruction of property by the elements, or fire or other hazards for which insurance proceeds are inadequate; (7) Theft and pilferage of property for which insurance coverage is inadequate; (8) Non-collectibility of receivables; (9) Liquidation expenses in excess of estimates; (10) Increased property taxes, sales taxes and other impositions which increase selling costs; and (11) Litigation with other claimants, as for example, creditors of the leased lines." (NHI-92 pp. 13-14)

At the time of the Inclusion Report, therefore, the Commission considered all of the alleged claims of "risks and uncertainties" which are now said to have been put forth once more by Mr. Simon in his testimony on the remand. The Commission rejected the argument for 7% rate in the Inclusion Report and, contrary to the Government's assertion, did not undermine that rejection in the Remand Report. The "bulk sale discount" was not the result of a fresh look at "unrefined appraisals" but a discount entirely dependent on the assertion of power to compel a sale to a middleman who would only purchase at a discount from fair market value in order to reap his middleman's profit when he resold the property at the fair market value reflected in the appraisals accepted by the Commission in the Inclusion Report.

Penn Central acknowledges (PC Br. p. 49) Simon's testimony reflected a method of valuation that would be used by a person proposing to buy the properties in bulk. It claims the method would be equally applicable to the valuation of the property for any purpose calling for a determination of fair market value, but it points to no evidence to support that claim, which at any event is shown to be without foundation by the fact that all of the appraisal witnesses, including Penn Central's own witnesses, made their determination of fair market value without using Simon's method.

It likewise attacks the Commission's valuations as too high and as failing to give sufficient weight to other risks. (PC Br. p. 50) It quotes with approval from the majority's opinion where the majority substitutes its views for those of the Commission and even the views of the witness. (PC Br. pp. 51-2).

> "In addition to the factors emphasized by Mr. Simon, there is the fact to which we have referred above, that the appraisals gave no effect to the serious adverse economic consequences from discontinuance of New Haven operations." (305 F. Supp. at 1095; App. 418a)

The briefs of the Government and the Interstate Commerce Commission and of Penn Central in support of the "bulk sale discount" overlook the Commission's findings and rationale. They reject the Commission's findings in favor of the assumption of the majority of the Statutory District Court. (Govt. Br. pp. 52-59; PC Br. pp. 44-61) The Government's brief *in support of the Commission* remarkably condemns every step of the Commission's valuation of the New Haven real estate and attempts to justify the bulk sale discount as a device which, by a happy coincidence, exactly corrects the total of the alleged errors the Government cites against the Commission.

Thus, the Government criticizes the Commission for failing "to define the exact period required for marketing . . ."; (Govt. Br. p. 52) for ignoring the testimony alleged to have shown that "a complete liquidation of the New Haven would have a drastic effect on the market for land in New England"; (*Id*) for relying on "unrefined appraisals". (*Id*) But the Commission did not withdraw its findings in issuing the Remand Report. It continued to conclude that the appraisals were "conservative"; that the marketing program could be accomplished in six years at the amounts set forth in the appraisals it adopted; and that the proper interest rate to use for discounting the proceeds of the six-year liquidation was 6%, which was the prime rate at December 31, 1966, the valuation date. (331 I.C.C. at 664; App. 22a) The Commission did not alter its decision that the division into 1,700 parcels for sale was reasonable.

Instead, the Commission assumed it could condition an abandonment certificate to one who would buy all of the properties of the New Haven for continued operation. (334 I.C.C. at 60; App. 147a) The Commission did not declare that this was the New Haven's best method of liquidation. It treated the existence of the power to condition abandonment certificates as a legal impairment of the values of the property and considered that it was pricing out the legal impairment. (334 I.C.C. at 57; App. 144a) It is for this reason that throughout the Remand Report and in the opinions of both Courts and in the most recent brief to this Court by Penn Central, the discount has been referred to as "a bulk sale discount". (See 305 F. Supp. at 1058; App. 416a) The Government and Penn Central implicitly concede the bulk sale discount cannot be justified on the basis of the Commission's power to require a bulk sale to a non-railroad user for break-up purposes. (Govt. Br. p. 54; PC Br. p. 56) This

requires the elimination of the "bulk sale discount" and the reinstatement of net liquidation value found by the Commission. The Reorganization Court and Judge Weinfeld proceeded in that manner.

It cannot be too strongly emphasized that Penn Central seeks to avoid the Commission's clear statement that the bulk sale discount was predicated upon the right of the Commission to impose restrictions on the disposition of the New Haven's real estate. Although the Commission lumped the two discounts of abandonment delay and bulk sale under one rubric, Penn Central supports only the abandonment delay discount on this ground. (PC Br. p. 27) Having recognized that the Commission was powerless to impose the bulk sale discount as a condition to an abandonment certificate, Penn Central argues that the "Commission's adoption of the discount did not depend upon any assumption that in a hypothetical liquidation the New Haven would or could be compelled to sell its real estate properties to a bulk purchaser". (PC Br. p. 56) When one considers that all that the Commission said on the subject of the bulk sale discount rested under the caption "Limitation on the right to break up the railroad", (334 I.C.C. at 60, App. 147a) it is apparent that Penn Central has asked the courts to ignore the plain meaning of the Commission's words and to substitute their judgment for that of the Commission. But to justify this request, Penn Central must show there was no substantial evidence to support the Commission's finding of a net liquidation value of $162.7 million which the Commission flatly made. (334 I.C.C. at 53; App. 140a) This burden could not be met. The Reorganization Court, on the other hand, holding the bulk sale discount deprived the New Haven of the fair upset price, did not substitute its judgment for that of the Commission. It determined a legal issue.

The Commission, responding to the request of the Statutory District Court on the first review, had set forth the

net liquidation value if the courts should not accept its so-called "other pricing considerations". The Statutory District Court had issued its order in that form to make a further remand unnecessary. (289 F. Supp. at 448; App. 376a) Alternate liquidation values were therefore set forth by the Commission. The New Haven has been in reorganization since 1961, and efforts to conclude the reorganization proceedings in 1970 should not be thwarted by remands when the Commission has itself set forth the alternate price.

The answer to Penn Central's and the Government's second argument (*i.e.* that the bulk sale discount should be sustained in any event because it is a recognized method of valuation and is fair because it accounts for risks overlooked by the Commission) is that the Commission did not overlook the risks. It found they were satisfactorily dealt with by a) adoption of conservative appraisals; b) discounting proceeds to present value; and c) applying severe discounts from conservative appraisals of the least valuable parcels to insure that even those properties would be disposed of in six years.

The appraisals the Commission adopted were made on the basis of anticipated sales to contiguous owners and to users, rather than on the basis of sales to developers or investors. (NHI-58 pp. 5-6; NHI-94, p. 9) Since fair market value is the value a willing buyer would pay to a willing seller, considering the highest and best use of the property,* the application of Simon's principle** would diminish net liquidation value in every case by the amount of the profit Mr. Simon considers necessary to a developer.

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* See *Boom Co.* v. *Patterson*, 98 U.S. 403, 407-8 (1878); *McCandless* v. *United States*, 298 U.S. 342, 345 (1936); *St. Agnes Cemetery* v. *State of New York*, 3 N.Y. 2d 37, 41 (1957).

** Simon's principle is that a bulk buyer must see a 15% return on his invested capital or he will not be induced to buy (334 I.C.C. 62, App. 149a).

The bulk buyer's price *confirms* the appraisals made on the basis of sales to contiguous owners and users. Unless the owner is to be deprived of net salvage value, he must receive the appraised values.

The Government attempts to meet the argument made by Chase that the Commission's deduction for the bulk sale was not measured by attention to any particular risk but rather was based on the testimony of Simon, "who did not know what precise risks were covered or were not covered by the appraisals". (Govt. Br. pp. 57-8) The Government argues that Simon's assumptions "adequately reflected the prior liquidation study". (Govt. Br. p. 58) But the Commission characterized the appraisals it adopted as "conservative". (331 I.C.C. at 664; App. 22a) A conservative appraisal is one which is at the lower end of a spectrum of realistic expectations. Depending upon how conservative the appraisal is, the discount for risks must vary. For optimistic appraisals, the discount may be larger. For conservative appraisals, the discount may be smaller. If Simon did not know how conservative the appraisals were, and indeed he did not, he could not suggest the percentage discount appropriate to the appraisal. He assumed only that they were carefully done by reliable real estate appraisers. (R-29, p. 3; App. 347c; App. 494c-495c)

Simon's testimony did not seek to quantify risks not taken into account in the appraisal of New Haven's real estate. It was directed only to a statement of the operations of bulk buyers and the yields they looked for.*

Penn Central also argues (PC Br. p. 56) that because a hypothetical immediate buyer for all of the New Haven's property, intending to resell the properties over a six-year period, would pay less than what the New Haven would

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* See pages 29, 30, *infra*.

realize by its best method of liquidation, the hypothetical wholesale buyer's price should nevertheless be declared the fair market value rather than the value the New Haven would realize by a liquidation in parcels over six years. It criticizes the Reorganization Court for not putting credence in the hypothetical buyer even though it admits in one breath that the hypothetical wholesale buyer is merely "an analytical device" and on the other "that it was proper to determine what a willing hypothetical buyer would pay for the land as a whole without regard to whether an actual bidder for all the land could be found". (PC Br. p. 58) Why it is reasonable to make an analysis for the purpose of finding what would be paid by a buyer who could not even be postulated to exist, is not clear. The analysis that was, in fact, made and adopted by the Commission was the analysis of what the property would bring if exposed to real buyers over a reasonable period so that the property could be sold at that price which an appreciation of its highest and best use would justify. The Commission considered the Penn Central analysis relevant only if it could command a bulk sale. (334 I.C.C. at 61; App. 148a)

Some miscellaneous points remain to be disposed of. Penn Central's brief asserts that the Reorganization Court was wrong in not treating the sprawling and disparate New Haven real estate as a single tract. (PC Br. pp. 56-57) It argues that

> "Numerous decisions hold that it is not appropriate to value an entire tract of land merely by aggregating the predicted selling prices of separate parcels into which the land might be subdivided, but that the value is to be determined by what a willing purchaser would pay for the entire tract before subdivision."

But the New Haven's property was not a single tract. The entire Penn Central argument falls because geography

and history had already subdivided the New Haven's real estate into many tracts, parcels and buildings. The appraisals simply treated the tracts, parcels and buildings reasonably. (App. 209c-211c) The appraisers did not attempt to agglomerate a tract or parcel in the South Bronx with a tract or parcel in New Haven for the purpose of making a less readily saleable commodity, but valued each tract or parcel indivdnally. The fact is the New Haven owned over 25,000 aeres, and the division into 1700 parcels represented a natural division of the property.

There was and is a real market for the New Haven parcels when marketed with a view to the convenience of buyers and seller alike. A prospective buyer willing to pay for the New Haven's office building in New Haven, for which he has a use, should not be required to purchase the Bronx yards, for which he has no use. If the New Haven office building prospective buyer is compelled to purchase the Bronx yards for which he has no use so that he can engage in the real estate business in an area unknown to him, the price of both the office building and the yards will be depressed. The existing division into normal size parcels was, therefore, essential to a determination of fair market value or net salvage value. The agglomeration of these parcels into a bulk for sale depreciates the value of each and every parcel. The Reorganization Court and the dissenting Judge properly rejected such a notion. Liquidation must be conducted in the manner likely to yield the best result.*

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* The Bondholders cited many cases for the proposition that the Commission's assertion of a power to compel a bulk sale discount as a condition of abandonment was contrary to its consistent disposition of abandonment cases. (Man. Br. p. 49; Committee Br. p. 55) To the bondholders' contention that the Commission has been uniformly careful to condition the abandonment upon the seller's obtaining the fair market value of his property (usually referred to as net salvage value), the Government and Penn Cen-

Penn Central argues that Simon found the difference between the fair market value of the New Haven land in the hands of its owner on the valuation date and the valuation arrived at in the New Haven's Trustees' liquidation study; that is, the predicted net proceeds from sales of New Haven land if sold in parcels over a six-year period after applying a 6% discount rate to such future proceeds. (PC Br. p. 47) What Simon has actually found is the difference between the value of the property in the New Haven's hands and what a bulk buyer of the New Haven's massive real estate for resale would pay. He testified:

> "Q. What basis have you for saying that the fair market value carefully appraised by reliable real estate appraisers is not what it is supposed to be, fair market value?
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> "A. Well, we are talking about two different things. One, we are talking about an appraisal of what a hundred, five hundred, a thousand, I don't know how many buyers were postulated here, but a great number of buyers were postulated and the appraisal, as I understand it, was made on what they would pay for the respective chunks of land.
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> "That has nothing whatever to do—that's not correct—that is only part of the calculation you have to

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tral do not respond. Penn Central did in fact comment on the cases, but only under the subject of abandonment delays, and then it sought to distinguish *Tennessee Central Ry. Co., Abandonment,* 331 I.C.C. 433 (1968) and *Jay Street Connecting R.R. Abandonment,* 307 I.C.C. 137 (1959), on the ground that the abandonment delays were not hypothetical but actual. (PC Br. p. 29) In the other cases it is said "the issue was never raised", (PC Br. p. 129) but that is precisely the point. The Commission until this case uniformly proceeded on the assumption that discounts from fair market value were not proper pricing considerations. Nor does Penn Central comment on the argument made at pages 35 and 36 of the brief of the New Haven Trustees based on *Rutland Ry. Corp. Abandonment,* 317 I.C.C. 393 (1962).

make if you want to find out what a single buyer would pay for the whole ball of wax.

"Q. You assume that the only sale of this property will be to one user? A. We are not talking today about users but we have been assuming a bulk sale and we have been discussing about the decision which is in the railroad's hands as to whether or not to go through the retail processes themselves or whether to make a bulk sale." (Tr. 29885-6; Rec. 496c)

Penn Central also complains (PC Br. p. 59) of the Reorganization Court's characterization of the bulk sale discount as imposing a "double deduction". The Reorganization Court was correct because the extreme deduction of $8 million as to $11 million of property remaining at the end of the fourth year was designed to account for the risks that conservatively priced real estate might remain unsold. Since the Reorganization Court found that the $8 million deduction and the $1 million contingency fund had sufficiently discounted the risk, it properly concluded that to require the New Haven to sell at a further discount to satisfy Mr. Simon's requirements for a 15% profit regardless of the extent of the risks, imposed a double deduction on the New Haven estate.

POINT III

The Government and Penn Central Have Failed to Establish That It Was Not Gross Error to Permit the Transfer to Penn Central of the New Haven's Right to Fully Paid Access to and Use of the Grand Central Terminal Without Consideration. The Commission Should Be Directed to Properly Value the $5,600,000 of Annual Income Now Used Without Restriction by Penn Central.

The States of New York and Connecticut continue to oppose a determination that the right of the New Haven to have $5.6 million of Grand Central Terminal revenues applied to pay the cost of operating its trains in the Terminal has substantial value. When that right is recognized, the States will suffer in their negotiations with Penn Central for the takeover of the New Haven division commuter service.* The brief of the State of New York now varies the theme by saying that the right in any event is not worth $70 million *but only about $27 million* (NY Br. p. 4). This results from its contention that the New Haven's share of net Terminal revenue is only $2.17 million which, capitalized at 8%, is about $27 million. This is far from saying that the right is valueless.**

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* Indeed, the sole interest of either of the States in the present proceedings is that they are in the process of acquiring much of the former New Haven operations and assets from Penn Central, including operating rights into Grand Central Terminal, and understandably seek to minimize the cost of those assets. Connecticut and New York are vying with Penn Central for the New Haven's income, which both would like to have without cost and without consideration to the New Haven.

** The State of New York reduces the $13.5 million of expenses found by the Commission to $9.5 million of "operating expenses" by deducting "interest on capital, expenditures, taxes, etc." (NY Br. p. 3). The amount of $9.5 million is further reduced by $4.2 million of income from the Terminal itself to reach a net amount of $5.3 million, of which the New Haven's 41% share would be about $2.17 million per annum. (*Id.*)

New York's analysis may be defensible from its own standpoint in its negotiations with Penn Central in that the State purports to view the railroad station alone and not to take into account all of the Terminal Properties. However, this does not alter the fact that until the transfer of the New Haven's property $5.6 million of Terminal income was used by the New Haven to pay the cost of operating the New Haven trains into and out of the Terminal and is now being received by Penn Central.

The brief of the State of New York (NY Br. p. 7) refers to the memorandum of intent* signed by the States of New York and Connecticut and Penn Central which relates to the takeover by the States of the New Haven Division commuter service between New Haven and New York City.** New York's brief asserts that the States "will re-

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* This memorandum is said to have been made public last November but is not in the record in this case. Final agreement as to the terms of the takeover is said not to have been reached.

** The State of Connecticut recognizes that thus far the New Haven has been denied consideration for its interest in the income from the Grand Central Terminal Properties which it had used to defray its expenses in operating into the Terminal because "the Court [Reorganization Court] noted further that it was highly speculative to expect any public authority to pay for the use of the Terminal '. . . in view of the bargaining positions of the States and the disposition by the I.C.C. to require Penn Central to furnish such access free of charge to a state or public authority which assumed the commuter service, as a condition of Penn Central's getting rid of that much of the losing and burdensome passenger service.'" (Conn. Br. p. 8) The bondholders have argued that if the New Haven ceased operations the importance of its service would require a public authority to condemn and provide that service. That this position was correct is established by the fact that a New York—Connecticut authority is now voluntarily taking over that service for the benefit of their citizens to provide them with improved service even though Penn Central is now required to provide the service. It is clear, therefore, that what the States are doing for their citizens when the circumstances are not as dire as they would have been had operations

ceive an annual credit of $2 million from non-Terminal income toward their share of the *net* Terminal expense, *which it is expected will give the States free use of the Terminal"* (NY Br. p. 7, emphasis added).* The contention of the State of New York then must be that it costs only $2 million per year to pay the operating expenses of the New Haven Division commuter trains in the Terminal, for which amount they will reimburse Penn Central.

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ceased would surely have been done on the assumption of the termination of the New Haven's operations. The Statutory District Court had said: "While we do not disagree with the bondholders' position that a state must pay the salvage value of property of a defunct railroad that it wishes to acquire, what is the salvage value of property that cannot be sold to anyone else and is of no value in the owner's hands?" (305 F. Supp at 1060, App. 420a) That question has been answered by the demonstrated fact that the property will be sold to a New York-Connecticut commuter authority. It is further answered by the *PATH* case (*Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Transit Tubes Corp.*, 20 N.Y. 2d 457 (1967), *cert. denied*, 390 U.S. 1002 (1968)), where, as here, the State was required to pay for a defunct railroad that could be sold to no one and was without value in the owner's hands. See also *Matter of City of New York (Fifth Ave. Coach Lines)*, 18 N. Y. 2d 212 (1966). The Statutory District Court had also said "Unless someone could be found to take over NH's operations into GCT, the right to have terminal income applied to expenses could not be sold to anyone even if the anti-assignment clause in the contract was not the obstacle that it may be." (305 F. Supp. at 1060, App. 419a) It is now evident that the court was in error in believing that no one could be found to take over the New Haven operations into the Terminal and in its assumption that the public commuter authority might choose to stop its service in the Bronx (289 F. Supp. at 431, App. 340a). Where, as here, a public authority has elected to take over the New Haven's operations the anti-assignment clause is inoperative because the service would have been acquired by operation of law. See authorities set out at Chase Br. pp. 77-79; Committee Br. p. 125, fn. 1.

* The $2 million amount results from a reduction in the $2.17 million referred to above to reflect the fact that operation of the New Haven division long-haul passenger trains will not be taken over by the States (NY Br. p. 7 fn. 3).

Since Penn Central is to give the States a $2 million credit, the States "expect" they will receive "free use" of the Terminal. How the State of New York can assert that the $2 million "credit" comes from "non-Terminal" income is difficult to see.* It appears that while on the one hand Penn Central credits the States with $2 million, on the other hand it receives $2.9 million from the States which it calls "tolls" (PC Br. p. 104); this would make it clear that the States are not obtaining "free use" of the Terminal. The parties to this transaction could have eliminated the credit and reduced the "toll" to $900,000; and that Penn Central is obtaining income from the sale of Terminal use.

Quite significantly, it appears from the New York State brief that the States will pay their part of the net Terminal expenses or slightly less than the New Haven's historic 41% of $5.3 million (NY Br. p. 7). In view of the reference (NY Br. p. 7) to the States' "share of the *net* Terminal expense", we can only assume, as we have argued throughout this case, that Penn Central's arrangement with the States will be in effect a "cost plus" contract with the States paying the cost of operation plus some fixed or incentive type compensation. As a result of this arrangement with the States, Penn Central, in addition to the tolls and other benefits which it is to receive under the agreement, will be reimbursed for operating expenses (presumably about $2 million) and at the same time it will retain $5.6 million of Terminal income formerly credited to the New Haven. Certainly Penn Central would not agree with the States to bear the operating expenses of the Terminal, such as tracks, switches, signals, etc. but would look to the States for re-

* From December 31, 1968 to date, Penn Central has received $13.4 million per annum from the Terminal Properties free of any obligations imposed by its prior agreements with the New Haven, and expends $13.85 million to pay its Terminal expense (334 I.C.C. at 39, App. 126a).

imbursement, presumably on the same car-use formula (41% to the New Haven) which existed prior to December 31, 1968. In any event, under the proposed agreement with the States, Penn Central will be paid twice—once by the income from the Terminal Properties of $5.6 million and again by the States when Penn Central receives the windfall of State reimbursement under the agreement for the States' share of the Terminal expense.

Penn Central makes the statement that after inclusion it "obviously gained no advantage from the income dedicated to Terminal expenses, since it had to pay all of the Terminal's expenses." (PC Br. p. 105) Penn Central overlooks the fact that the Terminal expenses attributable to its New Haven Division are now being paid from income from the Grand Central Terminal Properties formerly credited to the New Haven and Penn Central now also receives in addition all of the very substantial revenue from the New Haven commuter and long-distance trains which use the Terminal. Before December 31, 1968 this revenue went to the New Haven; it did not go into the Terminal Account.

In addition to being reimbursed by the States for the cost of operating the New Haven Division commuter trains in the Terminal, the cost of which is also being paid (in effect by the New Haven) from income from the Terminal Properties, and $2.9 million (labelled as "toll"), Penn Central will receive other valuable consideration from the States and, presumably, from the Federal Government (NY Br. p. 7).* It will be relieved of a deficit operation which it undertook in order to obtain approval of its

* Referring to the takeover arrangements, the brief of the State of Connecticut (p. 10) states that with Federal support the States are "undertaking a capital investment program of over $80,000,000 to modernize the service, including acquisition of new cars and improvement of stations and other facilities."

merger (and which it has pleaded justifies a low price for the New Haven assets) and will be reimbursed under the lease for the cost it incurs in operating the commuter service for the States. Penn Central will also benefit greatly from the "many millions" which will be spent to "modernize and rehabilitate the service" (NY Br. p. 7), since many of the improvements, such as improvements to tracks, power lines, signals, switches, stations and station platforms, will be available to its own commuter and long distance trains. Penn Central is thus bargaining away rights obtained from the New Haven to benefit itself in other areas.

Penn Central states that prior to December 31, 1968 it already had the right to "free use" of the Terminal for its trains (PC Br. p. 105). This disregards the fact that the New Haven also had the "free use" of the Terminal for its trains and received all the revenue from those trains. Now Penn Central operates the former New Haven trains, has the Terminal expenses of these trains paid out of funds from the Terminal Properties formerly belonging to the New Haven, and receives all the revenue from the New Haven Division commuter trains.

Penn Central continues to object to having to take over the New Haven (even though it is being relieved of a principal burden, the commuter operations), having forgotten, apparently, that Pennsylvania and New York Central voluntarily contracted to purchase the New Haven in order to remove an obstacle to their merger and assumed that, under Penn Central management and with the additional State and Federal aid to commuter service then in contemplation, the New Haven Division's financial condition would be greatly improved. Penn Central fails to note that for $28,887,000 it is buying the New Haven's full partnership interest and thereby obtaining clear title to some of the most valuable property in the United States—prop-

erty which was appraised as of April 19, 1965 at $227,225,000. Penn Central is enjoying and the States will share the windfall represented by the New Haven's $5.6 million of annual income.

Whether this Court should determine that the New Haven is entitled to the capitalized value of $2 million of income or $5.6 million of income, the New Haven's interest in the income flow must fairly be compensated.

POINT IV

The Government and Penn Central Fail to Sustain the Premise That Rail Service Would Not Be Available to Industrial Users in the Harlem River and Oak Point Yards. The Reorganization Court Was Correct in Concluding That the Record Compelled the Conclusion That Rail Service Would Be Available.

In the Remand Report the Commission stated:

> ". . . we find that the $18,090,000 appraisal of the trustees which we accepted in the inclusion report was based correctly upon an assumption that *all railroad service to the Harlem River and Oak Point yards would terminate upon the liquidation of the NH.*" (334 I.C.C. 47; App. 134a; emphasis added)

This statement is the basis for the Commission's acceptance of the $18.1 million valuation instead of the $22.539 million found by the Reorganization Court (304 F. Supp. at 1137; App. 318a) on the assumption that rail service would be available.

The Commission further stated:

> "The record does not support any finding of substantial need for Penn Central service that would jus-

> tify the construction by that carrier of the track necessary to connect Harlem River and Oak Point yards and the latter yard and Hunts Point, if NH were to be liquidated. . . . On this record, and the assumption of NH's liquidation *and the dismantling of its system,* Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market". (334 I.C.C. 47; App. 134a; emphasis added)

The Commission stated that Penn Central:

> ". . . argues with considerable logic that it would not be legally obligated to perform switching service beyond its own line or extend its line to service NH's industries if the present joint rates were terminated by NH's liquidation." (334 I.C.C. 45; App. 132a)

These quotations show that the Commission here, as in its imposition of the bulk sale discount, denied the New Haven its best method of liquidation and thereby, its constitutional right to net salvage value. It assumed that the only liquidation method available to the New Haven is dismantling, even if dismantling results in a depreciation of its real estate. All of the Commission's conclusions depend upon this assumption, which the Reorganization Court characterized as absurd (304 F. Supp. at 808, App. 297a) and which Judge Weinfeld rejected with the statement:

> "Its finding as to non-operation of the yards made with respect to Penn Central, any existing terminal carrier, a new terminal carrier or the City of New York does not appear to be based upon substantial evidence. It is difficult to agree that an important rail service to industrial users would be terminated

and the line dismantled. Nothing in the record supports the Commission's assumption that the properties would be stripped of their trackage and electricity, both highly desirable industrial features, and the former alone commanding about a 10% premium in Bronx realty values." (305 F. Supp. at 1070, App. 442-43a)

The Reorganization Court must be sustained if:

(a) New York City was willing to acquire the small piece of New Haven track between the Hunts Point Market spur track and the Oak Point yards; or

(b) a certificate of abandonment of the section of the New Haven's line which joins Oak Point yard to the City's spur track was conditioned upon a sale to Penn Central or New York City at net salvage value and either exercised their option; or

(c) a terminal operator or industrial developer acquired the track; or

(d) failing the first three alternatives, the track was donated to New York City, a terminal operator or industrial developer to preserve rail service to the Harlem River and Oak Point yards and the Hunts Point Market.*

Neither the Commission nor the Government met the Bondholders' position that:

"By statute, it is the duty of every common carrier 'to provide and furnish transportation upon reason-

* Assuming that the New Haven were forced to transfer the right of way without cost, it might be that it would be giving up property worth $500,000, as Penn Central suggests (PC Br., p. 69, fn. 3), but it is at least equally probable that the New Haven could obtain fair value for the right of way, whether by sale or condemnation and perhaps even more than liquidation value by a "sale in place", as the Statutory District Court recognized (289 F. Supp. at 436, App. 349-50a).

able request therefore' 49 U.S.C. §1(4) and to provide switch connections and cars for traffic to branch lines or private side track constructed by a shipper to connect with the railroad 49 U.S.C. §1(9)". (Committee Br. p. 147)

It has already been shown that the present connection between Penn Central's Port Morris branch and the New Haven line to the Harlem River and Oak Point yards and to the Hunts Point spur track constitutes such a branch line or side track.

To suggest that the obligation of a common carrier to render transportation service stops at the physical end of its line, regardless of what connections exist to industries in the immediately adjacent area, ignores such decisions as *United States* v. *American Tinplate Co.*, 301 U.S. 402, 409 (1937):

"It is conceded that the line haul rate covers delivery. Such rates are usually made to or from an area, sometimes designated 'switching districts' or 'switching limits'. Within that area the carrier holds itself out as agreeing to deliver freight in its freight depot or at team tracks or on sidings or spur-tracks owned by an industry. The practice has come to be uniform that in delivering a car on a team track the carrier will spot the car at a point where merchandise of the class contained in the car is usually and most conveniently unloaded; . . . In the analogous situation where an industry's warehouses or other facilities are located at a given spur or side-track, the carrier holds itself out to spot the car at the point where it is needed for loading or unloading, as a warehouse door, a scrap pile, etc. etc."

In *United States* v. *U. S. Smelting & Mining Co.*, 339 U.S. 186, 189-90 (1950), this Court stated that:

> "The Commission concluded that carrier obligation for transportation service ends customarily when a delivery is made at a convenient point on the siding inside or outside an industrial plant. This delivery is such as may be accomplished in one continuous movement without 'interruption' occasioned for the convenience of the industry, and is only the equivalent of team track or simple placement switching. In the Commission's view as developed in *Ex Parte* 104, such a convenient delivery point marks the beginning and end of what is termed 'line haul' transportation, and is the extent of the service which may be performed under the line haul rate."

Penn Central's line-haul obligation obviously cannot stop at the end of its interchange track (which has no team track service, unloading platform or any other facilities to handle freight) and fail to include the additional service of simply spotting cars at sidings directly connected with that interchange track. Even Mr. Weaver, Penn Central's witness in his direct testimony, did not question that industries located in the two yards could acquire the New Haven trackage connecting them with the Penn Central interchange track, and that Penn Central would be obligated to spot cars at industries along that line. (R-27 p.3)

Penn Central argues that *Ex Parte 104,* 209 I.C.C. 11 (1935) supports the proposition that Penn Central's obligation is limited "merely to spot cars on the spur track beyond the clearance point of its line" (PC Br. p. 73fn.); that is to say, beyond the clearance point of its interchange track at Port Morris. *Ex Parte 104,* however, was concerned not with spotting of cars at normal industry side

tracks but with the activity of carriers which served very large industrial plants such as steel mills, smelters, automobile factories and the like, in going deep into plant territory and conducting switching operations between various units of the privately owned complex. The distinction appears from the passages quoted below.*

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* "The published tariffs generally establish switching limits at the various destination points. Delivery within those limits is paid for when rates are collected to those destinations. In some cases the switching limits are definitely defined by boundaries, and at others the industries included within the switching district are named. There is no dispute that delivery at the various industries is covered by the published rate. The difficult thing is to ascertain when delivery at the plant is made. In the nature of things no inflexible formula can furnish a solution for that problem. The limitation of space within which delivery is due will vary with varying conditions. All that we can safely say is that *there must be such a delivery as is customary and reasonable.* Delivery by railroad is usually effected either at freight houses or other terminals, and deliveries are still made at such places where the factories and warehouses of shippers and consignees do not connect with the tracks. *Private sidings have become common and freight is carried over them between the railroad and the plant. Such carriage is commonly regarded as a part of the work of transportation.* In most cases the distances are short and the carrier's burden remains substantially the same whether the cars are left upon the siding close to the main tracks or hauled along the siding until they reach the plant. In such circumstances it may be said within reason that delivery at the plant means delivery at the platform for loading and unloading. . . . What many of the industries here insist upon is that the respondents must haul them even farther along an intricate system of interlacing tracks and distribute them among the mills and warehouses not at the convenience of the respondents but in order to meet the industrial needs of the plant. We come then to the test, which vague as it is, is the only safe one, that is, whether in the light of all the circumstances such a form of delivery is customary or reasonable. That it is not customary is established, we think, by uncontroverted evidence. Spotting cars upon short and direct sidings is a service that has little kinship to intricate maneuvers designed not to reach the industry but to permit the convenient distribution of wares among the subdivisions of the industry. The difference may be one of degree but here as is so often in the law such differences are vital." 209 I.C.C. at 17-18 (Emphasis added)

Indeed, *Ex Parte 104* was liberalized by the Commission in *Carrier Switching at Industrial Plants,* 294 I.C.C. 159 (1955), which held that much intra-plant switching constituted service which was part of the line haul rate, provided that the carrier could perform the service at its convenience and without material interference from the shipper. Since then, the Commission has on numerous occasions held that carriers could pay switching allowances to industrial plants which perform their own intra-plant switching, e.g.; *Ford Motor Company Terminal Allowance,* 310 I.C.C. 297 (1960), and that under some circumstances carriers could be compelled to pay switching allowances for intra-plant operations, e.g., *Kohler Co.* v. *Chicago & N.W. R.R.,* 311 I.C.C. 643 (1960). Mr. Shannon, who testified for the bondholders, was clearly correct that, if Penn Central declines to perform the services of spotting cars at industries located on side-tracks connecting with the Port Morris branch, an allowance for these industries could be compelled under Section 15(13) of the Interstate Commerce Act. (Tr. 29659) This would apply to the 50 industries in the Oak Point—Harlem River area that now have rail sidings and are rail customers, to the Hunts Point Market, and to any industries which would locate in the area in the future.

The Commission has the power under Section 1(21) of the Interstate Commerce Act to require Penn Central to acquire the New Haven line to Hunts Point although Penn Central argues to the contrary (PC Br. p. 70). Penn Central cites *I.C.C.* v. *Oregon-Washington R.R. & Nav. Co.,* 288 U.S. 14 (1933). This case related to an order which directed the railroad to construct a 185 mile line traversing 20 miles of swampy area, 15 miles of alkali flats and then 115 miles of desert. The Court said that "The region is in part sparsely settled and in part wholly uninhabited,

and contains no towns except Crescent and Crescent Lake at the western extremity, neither of which has a population of 100. There is no town within 20 miles north or south of the proposed line." The cost of construction of the line, in 1927 dollars, was estimated at between $9,900,000 and $11,700,000. Rather understandably, the Court concluded that Section 1(21) did not contemplate requiring the carrier to expend that kind of money for virtually no traffic. As the Court noted, however, the test is whether the carrier has "undertaken to serve" the area in which the line is to be built or taken over. "Congress recognized a radical difference between compelling embarkation in a new venture and ordering a mere extension of facilities required as the natural concomitant and complement of those presently used for the rendition of the service to which the carrier has committed itself." 288 U.S. at 37.

More relevant to the present problem than the *Oregon-Washington* case is *City of Milwaukee* v. *Chicago and Northwestern R.R.*, 283 I.C.C. 311 (1951). Here the Commission held that it was empowered to require the Milwaukee Road, which owned a line that reached within a short distance of a large harbor terminal operated by the City of Milwaukee, to extend its line across the main line of the Northwestern railroad and connect with the harbor side tracks. With respect to the issue under Section 1(21) of the Act, the Commission stated (283 I.C.C. at 313-14):

> "While our authority under paragraph 21 of Section 1 to require a carrier by railroad to extend its line does not include extensions into new territory beyond the carrier's undertaking, the extension here into the harbor terminal, within the Milwaukee corporate and switching limits, clearly would be well within the Milwaukee's undertaking and 'holding out'. *Cf. Interstate*

Commerce Commission v. *Oregon—W.R. & Nav. Co.*, 288 U.S. 14, 38-40. As was found by the division, the connection here sought between the Milwaukee and the Harbor terminal would constitute an extension of the line of the Milwaukee within the meaning of paragraph (21) of Section 1 and the provisions thereof authorizing us to require a carrier to extend its line or lines."*

If this result was reached, even though no direct service to the harbor terminal had ever been provided by the Milwaukee, it would seem *a fortiori*, that Penn Central, which moves 85% of the traffic to Hunts Point for 99% of the distance between the western connections and the terminal market, is clearly "holding itself out" to furnish the service to Hunts Point, and that an extension of its line to the market would well be within the area it has agreed to serve.

In view of the fact that Penn Central indeed has a legal obligation to serve industries which provide sidetracks connecting with the Port Morris branch, and that it probably has the duty to acquire connecting trackage at its own expense, little discussion of the other points made in its brief is required.

It is asserted that the unprofitability of the Hunts Point traffic, a conclusion which depended upon the cost study which the Commission inserted in its Remand Report at 334 I.C.C. 46, but which was not in evidence or the subject of any prior notice, would cause Penn Central not to be

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* An unreported decision of the U.S. District Court for the Northern District of Illinois, which rejected the North Western's challenge to the I.C.C. order, was affirmed by the Supreme Court per curiam. *Chicago & North Western Ry. Co.* v. *United States*, 344 U.S. 871 (1952).

interested in serving the market or the yards. Penn Central asserts:

> "Weaver [Penn Central witness] further testified that the perishable traffic is unprofitable to Penn Central." (PC Br. p. 66)

But that testimony relates only to Penn Central's existing revenue and does not include the $80 per car division which the New Haven received. (Tr. 29693-4; App. 422c-423c)

Penn Central also argues that Weaver testified, in effect, that Penn Central would not make the investment necessary to carry on the traffic to Hunts Point Market. Weaver is quoted as follows:

> "I will recommend that they do that [give up the Hunts Point Market traffic] on the basis that I don't think it's a profitable proposition for a capital investment of that size." (PC Br. fn. 3 p. 66)

However, Weaver, in making that statement, believed that the investment would be the cost of the Harlem River and Oak Point yards and not merely the acquisition of the connecting track. Mr. Weaver testified in response to questioning by Manufacturers' counsel:

> "Q. Do you know how much you would have to invest, sir?
>
> "A. No sir. On the appraisal it says 22 and a half million dollars.
>
> "Q. To put a line through there? Is that what it says, it costs you 22 and a half million dollars to put a line through the Point?
>
> "A. That's the appraisal I read"
>
> (Rec. 403c-404c).

The clearance problems stressed by Penn Central (PC Br. pp. 67-8) are mere diversions. The bulk of the traffic to Hunts Point is presently delivered to the New Haven by Penn Central at the Port Morris interchange with the Oak Point yards and proceeds to Hunts Point. (R-16 pp. 5-6, Rec. 330c-331c) At present, therefore, the clearance problem is being met. If the time should come when new and larger cars are required, the problem can be simply corrected. It has been pointed out that common railroad industry practice is to try to improve clearances where necessary to retain and attract traffic. (R-16 pp. 9, 10; Rec. 333c-334c) Exhibit R-46, a clearance diagram of the Port Morris line, shows that there are only two points which cannot take an A.A.R. Plate C car, the maximum height of which is 15′ 6″, and which is the largest standard bulk freight car in regular service. At one of these points (M2), Plate C cars can clear the eastbound track. At the other point (M6), Plate C cars miss clearing the obstruction by only two or three inches which could be relieved by depressing the rail line.

Both the Government brief (p. 60) and the Penn Central brief (p. 64) argue that McCann's first and higher appraisal would apply "only if the *same* services New Haven provided would continue to be provided upon New Haven's liquidation". (Govt. Br. p. 60) Their emphasis is misplaced. As the Commission itself recognized, (334 I.C.C. at 43; App. 130a) McCann's higher appraisal depended upon whether rail service was available to the yards.

It is known that the Hunts Point Market receives the bulk of the City's produce, fresh fruit and vegetables. Penn Central admits 15,000 cars a year are passed to the market, nearly all of which come through the Port Morris interchange from Penn Central except for about 5 cars a day by the New York Connecting Railroad. All cars move

for about one mile over the main line to the Hunts Point turnout.* (R-16 p. 5, Rec. 330c) The testimony was that plans are underway to move meat, citrus, dairy, fish and flower industries to new sites in the market area. The compelling necessity to provide service to the Hunts Point market is clear.

Speaking of the Commission's powers in respect of abandonment certificates, the Commission said:

> "The foregoing liquidation value assumes that this Commission has no function under the Interstate Commerce Act to decide whether public convenience and necessity permit the abandonment of NH's entire line or portions of it. In view of our often repeated findings that there is a public need for the service of this railroad, there is no warrant for assuming that the creditors may now break up the railroad or devote the properties to another use." (334 I.C.C. 54-55, App. 141a-142a)

But in connection with the Oak Point and Harlem River yards, where in liquidation the Trustees would voluntarily preserve the necessary segment in order to preserve the value of the real estate, the Commission has proceeded on the single assumption that liquidation involves the destruction of the track and the end of rail service.

Finally, even Penn Central's witness testified:

> "It seems unlikely that termination of the New Haven's railroad service would have a really depressing effect on the location under consideration. The New York Central Railroad's Port Morris freight yard is less than 300 feet away from the New Haven's Oak Point

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* The Hunts Point Market spur track is also approximately one mile in length.

yard and is less than 3000 feet from the Harlem River yard. *Industries needing railroad service would doubtless, continue to get that service . . .*" (NHI-95 p. 3, Rec. 194-95c)

The Reorganization Court and Judge Weinfeld were obliged to reject the Commission's determination that there was substantial evidence that the yards would be without service when the evidence required "the Commission should have concluded precisely the opposite". (304 F. Supp. at 807, App. 296a).

There was no need in the circumstances for the Reorganization Court to remand to the Commission. The appraisals of McCann were not in question—the premises of McCann were in question. The premise that rail service would continue was required both in logic and in law (See pages 40, 41, *supra*).

POINT V

The Government and Penn Central Fail to Establish That the Issue of the Proper Discount to Present Value Was Not Properly Before the Lower Courts; the Commission's Determination Was Not Supported by Substantial Evidence; the Decision of the Reorganization Court Was Supported by the Record and Was Consistent With the Credible Evidence.

In its brief, the Government makes no attempt to defend substantively the Commission's conclusion as to the appropriate discount to present worth. Penn Central concedes that at least two of the errors charged to the Commission in the bondholders' June 17 submission* to the Reorganization Court, amounting to an overstatement of approximately $3.5 million, were made and that there was an added miscalculation, disputed in amount, which caused an understatement (PC Br. p. 79).

Both the Government (Govt. Br. pp. 64-65) and Penn Central (PC Br. pp. 74-81) nevertheless argue that the errors should not be corrected because the bondholders did not assert this position until their letter of June 17, 1969, commenting on the Commission's letter to the Reorganization Court of June 10, 1969.

Both the Government (Govt. Br. pp. 64-65) and Penn Central (PC Br. pp. 74-81) misconceive the position taken by the bondholders below and the state of the record upon which the Commission and the Courts made their

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* It should be noted that this letter was filed in response to the request of the Reorganization Court (304 F.Supp. 811-12, App. 302a) that the parties should comment on the Commission's letter of June 10, 1969 and was not a post facto innovation by the bondholders, as both the Government (Govt. Br. pp. 64-65) and Penn Central (PC Br. p. 78) imply.

determinations with respect to the discount to present worth. As was noted in Manufacturers Hanover's main brief (pp. 74-75), the bondholders introduced evidence during the remand hearings before the Commission as to what the appropriate discount to present worth should be and Penn Central presented a similar analysis. As was pointed out to the Commission and the reviewing courts, both the analysis of the bondholders' witness and the analysis by Penn Central's witness showed that the figure initially accepted by the Commission, based upon the testimony of Mr. Gordon, was incorrect.* We did not consider it necessary to analyze, in arguing to the Commission or in initially arguing to the courts, the difference between the very sketchy testimony that Mr. Gordon had given on cross-examination and the detailed study that was put in evidence by Dr. Altman (for the bondholders) and Mr. Hull (for Penn Central). Rather, in view of the concessions implicit in Mr. Hull's analysis of the present worth that the Gordon figures were incorrect, we considered that the Hull testimony provided the logical base line for our argument and therefore emphasized the differences between the bondholders' analysis, presented by Dr. Altman, and Penn Central's analysis presented by Mr. Hull. We also noted that there were other obvious deficiencies in the Commission's figures, notably the fact that while it had made adjust-

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* Thus, for example, the heading for this point in the initial briefs of Manufacturers Hanover to the reviewing courts read as follows: "Penn Central has Conceded that the Figure Adopted by the Commission for Discount of Gross Receipts is Wrong; the Undisputed Evidence Shows That It Is; the Commission's Refusal to Consider the Proper Discount of Gross Receipts of Liquidation Is Arbitrary, Capricious and Erroneous" (Brief of January 17, 1969, p. 65; R. Doc. No. 9). Manufacturers Hanover had made the same points in its briefs to the Commission after the Remand Hearing. The point is discussed at pp. 75-82 of Manufacturers Hanover's Initial Brief and at pp. 19-21 of its Reply Brief to the Commission.

ments in Mr. Gordon's basic liquidation values, it had failed to reflect those adjustments in its discount analysis. The Commission, in spite of Penn Central's concession, refused to reconsider its initial decision in any respect.

Manufacturers Hanover made essentially the same argument in the appeals to the Statutory District Court and to the Reorganization Court,* and the Reorganization Court agreed, in its initial decision that the Commission's determination of the discount to present worth was wrong, and directed it to make a new analysis of the discount to present worth of the liquidation receipts "in accordance with generally accepted accounting principles and based upon the changes made in valuation items through and including those stated in the present opinion". (304 F.Supp. at 810-1, App. 302a)

When the Commission attempted to follow out this mandate, the Commission's effort only served to dramatize the inadequacies of the original analysis. The obvious difficulty with the Commission's attempt to arrive at an adjustment in the discount to present worth computation by applying

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* In Manufacturers Hanover's reply brief to the courts, responding to a suggestion by Penn Central based on the work papers as to the assumptions which Mr. Gordon had made, we did discuss the Gordon work papers to some extent and referred to a copy of the Gordon work paper which we intended to file with that reply brief. Through an inadvertence in the compilation of the brief, the appendix was omitted and was thereafter submitted as a post-filed correction. In the course of that discussion, we noted (Reply Brief of Manufacturers Hanover to the reviewing courts, dated March 14, 1969, p. 65; Document No. 65):

> "It happens to be true that Mr. Gordon computed his discount of receipts on the basis of an incomplete discount of receipts omitting a number of receipts of which every other discount witness has been aware." (citing Tr. 23419-20)

The thrust of Manufacturers Hanover's argument in the courts, as it had been in the Commission, was that the Commission's initial figure was plainly wrong, a proposition on which both the bondholders' evidence and Penn Central's evidence were in agreement.

to the Gordon analysis the changes in valuation that had resulted from the prior proceedings was that in several areas the Commission's adjustments involved matters on which Mr. Gordon had never taken a discount. Thus it was necessary, in commenting on the Commission's June 10, 1969 letter, to come to grips with the details of the Gordon analysis, and to speak specifically of the differences between the virtually identical approach used by Mr. Hull and Dr. Altman and the quite different way in which Mr. Gordon had made his analysis. Those differences were what have been referred to as the "four errors." To say that they were not involved in this case prior to the filing of the bondholders' June 17 letter, is to disregard the fact that it was precisely by avoiding those "four errors" that the Altman and Hull studies reached the results that they did. Thus, the only contribution of the June 17 letter was to provide another analytical approach to the evidence put in by Penn Central and by the bondholders, by explaining it in terms of the errors in the original Gordon analysis rather than as a comparison between the Altman and Hull studies, both of which had recognized the errors and corrected for much, if not all, of them.

Penn Central deals with the substance of the discount point only briefly (PC Br. pp. 80-81). Understandably, Penn Central fails in that discussion to even advert to the facts discussed in the main brief of Manufacturers Hanover (p. 75) that its witness, Mr. Hull, had made a discount analysis in the initial proceeding and that his second discount analysis was signally at variance with the original one, particularly in terms of the timing of receipts. As was noted in our main briefs (Man. Han. Br. p. 75; Committee Br. p. 134), the essential differences between the Hull analysis and the Altman analysis were differences as to the timing of receipts. Dr. Altman based his analysis upon the testimony in the initial hearings that went to make up the

liquidation valuations that the Commission accepted in its initial report and has continued to accept; in some cases where such evidence was lacking, Dr. Altman accepted the schedules developed by Mr. Hull in his original discount analysis (Cf. Rec. 371-73c). Mr. Hull frankly conceded that the timing assumptions that he used in his second discounting study were different from those he used in his original discounting study and were also inconsistent with the timing evidence of the valuation witnesses (Rec. 442-46c). Moreover, Penn Central certainly cannot hide the fact, although it attempts to deprecate it (PC Br. p. 75 fn. 1), that Mr. Hull's final discount figure for receipts was $600,000 lower than the Commission's figure (Rec. 362c).

Penn Central complains (PC Br. pp. 79-81) of the Reorganization Court's acceptance of the bondholders' evidence since Penn Central had presented conflicting evidence which, in Penn Central's view, was "probably more correct." The Reorganization Court, however, obviously not only disagreed with Penn Central about which evidence was more correct, but also concluded, after extensive argument and an analysis of the detailed evidence before it, that the bondholders' analysis was correct.

There is, we submit, no basis to assert that the position of the bondholders that the discounting of the Commission was wrong has not been consistently urged before the Commission and in the reviewing courts. It is likewise clear, we submit, that the figure accepted by the Commission has been shown to be error by the witnesses for both Penn Central and the bondholders.

The decision of the Reorganization Court should be affirmed.

POINT VI

Neither the Government nor Penn Central Justify the Commission's Requirement That the New Haven Transfer to Penn Central Non-Operating Properties Without the Payment of any Consideration.

The New Haven was required to transfer 91,344 shares of the common stock of Railway Express Agency, Inc. (REA) to Penn Central without consideration, although at the time of valuation there was an offer outstanding for the shares of $1,826,880.* It was also required to transfer 15,000 shares of the common stock of New York Connecting Railroad Company. The Government, while recognizing that these New Haven investments are not operating properties necessary to Penn Central's operation of the New Haven service, appears to imply that a justification for their transfer without consideration is to be found in their characterization of the shares as "rail-related" (Govt. Br. p. 85). The Government does not appear to deny the existence of the offer for the REA shares. Nor does it deny that both companies still continue to operate. It follows that some market for these shares must exist. This drives the Government to argue that since the New Haven operating properties were valued on a hypothetical liquidation basis, it is appropriate to value the New Haven shares in REA and New York Connecting on the hypothesis those companies were liquidating. (Gov't Br. p. 84). But the hypothetical liquidation valuation approach is not germane to companies not in bankruptcy or dissolution.

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* In the Committee Brief, a typographical error placed the value of the offer for the shares at $182,688 (Committee Br. p. 152 fn.).

The Government also argues that if the shares are worthless the New Haven has not been injured. If, however, the shares are worthless, Penn Central would not be fighting to retain them and to relegate the New Haven to new valuation proceedings on remand. Nor would the Commission have found any reason to require their transfer. Penn Central now claims that since the shares passed at the closing on December 31, 1968, the bondholders are "barred by principles of *res judicata* from challenging the *transfer* of these investments to Penn Central. Only their right to contest the *valuation* was preserved. . . ." (PC Br. pp. 110, 111.)

The case of *Stoll* v. *Gottlieb*, 305 U.S. 165 (1938) relied upon by Penn Central is not applicable to this case. In that case, the plaintiff brought in the State Court a collateral attack upon a decision in a Federal Court, the plaintiff arguing in the State Court the Federal Court's lack of jurisdiction. The plaintiff had earlier been denied relief in a direct attack on the Federal Court's jurisdiction. In the instant proceedings, the situation is entirely different. The Reorganization Court left open specifically the rights of the parties to litigate the adequacy of the consideration. Penn Central filed a notice of appeal from the Reorganization Court's order requiring Penn Central to close on December 31, 1968. That appeal was consolidated with the appeal from the Reorganization Court's order on review of the Remand Report. Penn Central's Petition for Certiorari in case #1038 applied to the consolidated appeals.* Penn

* The Notice of Appeal from the Reorganization Court Order #559 (directing the transfer of properties) was filed by Penn Central in the Court of Appeals for the Second Circuit on January 23, 1969. The appeal was consolidated with all the appeals of all the parties by order of the Court of Appeals (October 7, 1969) (Rec. Doc. #53). Penn Central's Cross-Petition for a Writ of Certiorari to this Court declares ". . . Penn Central respectfully prays that, if this Court grants said petitions [the Bondholders' petitions for

Central admits that the valuation of the New Haven investments is before this Court. (PC Br. p. 111)

Penn Central relies on *Stoll* v. *Gottlieb, supra,* to support the rule that repetitious litigation of the same issues before courts of equal jurisdiction must be avoided to prevent the prolongation of litigation. That this is the basis for Penn Central's reliance can be seen from the cases cited in the brief of Penn Central.* But the *Stoll* principle is inapposite here. It is evident the Reorganization Court and the Statutory District Court anticipated that all the questions relating to the propriety of the Inclusion and Remand Reports and the valuations assigned would be reviewed by this Court which alone could make a final determination. No purpose would be served by a remand for valuation other than the prolongation of the proceedings. If the Government is right that the shares have no value Penn Central cannot be injured by a redelivery of the shares. A remand would presumably fix the fair value of the securities and Penn Central would be required to pay that value. The exchange of equivalents could be avoided by the return of the unpaid-for shares and would avoid the prolongation of this litigation.

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certiorari], its review be extended to include the issues pending in the United States Court of Appeals for the Second Circuit upon the appeals of Penn Central from the orders of the Reorganization Court." See also Penn Central's cross-petition p. 3. Penn Central's petition for a Writ of Certiorari was granted. Its appeal is Case #1038.

* PC Brief, p. 111 fn.

POINT VII

In the Circumstances of This Case, This Court Should Allow "Going Concern" Value in Addition to Liquidation Value, at Least as to New York Based Assets.

In their discussion of "going concern" value, which the Commission found to be $5.5 million, both the Government (Govt. Br. pp. 71-74) and Penn Central (PC Br. pp. 107-110) take essentially the same position, namely, that federal law governs the valuation principles in this case and that, even assuming arguendo New York law is applicable, the facts of the New Haven case are distinguishable from those which the New York courts passed upon in *Port Authority Trans-Hudson Corp.* v. *Hudson-Rapid Transit Tubes Corp.*, 20 N.Y. 2d 457 (1967) *cert den.*, 390 U.S. 1002 (1968) (the *"PATH"* case).

The first argument misses the bondholders' point. We do not dispute the fact that federal law governs in this case.* Assuming arguendo that general federal condemnation law provides no compensation for going concern value, the question is whether, in the circumstances of this case, federal law ought to look to the applicable law of the locality where a substantial portion of the property is situated in fashioning its valuation standard. In this case, on account of the public interest, the New Haven properties were required to be sold to Penn Central, thereby avoiding liquidation and the possibility (indeed the probability) that certain portions of its lines would be condemned by

* The bondholders dispute the contention that general federal law does not provide for compensation for going concern value in addition to liquidation value. On the contrary, we submit that federal law provides compensation for going concern values in an appropriate case. *Kimball Laundry Co.* v. *United States*, 338 U.S. 1 (1949). The Statutory District Court disagreed. (289 F.Supp. at 435, App. 348a.)

the local public authorities in order to maintain public transportation service.* Under these circumstances, we submit, the reasons for applying the valuation principles of the New York courts are compelling since they measure what the recovery would have been if condemnation had occurred when liquidation of the railroad commenced.

Thus, we submit, the unavoidable question is what rule of law the New York courts would have applied in this case. On that point, we submit, the situation in *PATH* is indistinguishable from the situation here. In both cases, it was possible to arrive at "scrap" value for a substantial part of each railroad's assets and "scrap" value was awarded in each case (for the land, buildings, and cars in the case of *PATH* and for the land, buildings, rolling stock and certain other physical properties and investments in the case of the New Haven). In each case there remained an important piece of engineering which had no "scrap" value or even a negative scrap value. In the case of *PATH* this was the tunnel under the Hudson River. In the case of the New Haven, it is the developed right-of-way, including tunnels, bridges, embankments, cuts, etc. In both cases, the reconstruction cost of either structure would be enormous and both are necessary for the intended use which led to the compulsory transfer. This is precisely the situation in which the New York courts found that under the standards of "just compensation"** an allowance was required to take into account this "going concern" value. It is misleading to state, as the Government does (Govt. Br. p. 74), that "the total valuation of the New Haven, unlike the zero valuation given the tunnel in *PATH*, is manifestly fair and just." A large pool of assets of the New Haven have

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* Indeed, it now seems clear that a great deal of the New Haven's New York-based assets will be acquired by the New York-Connecticut commuter authority.

** See *PATH*, 20 N.Y.2d at 468-70.

been valued at "zero" although other assets of the New Haven are assigned a positive "scrap value".* Identically, in *PATH*, an award of over $21 million was given for the "scrap" value of *PATH's* rolling stock and buildings. But there an additional award was made for the tunnel's "going concern" value (on the basis of the original cost less depreciation).

What the *PATH* decision, as well as the decision of the New York Court of Appeals in *In the Matter of the City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y. 2d 212 (1966) also make clear is that in appropriate cases going concern value is an additional element of value and not an alternative to liquidation value, regardless of profitability. The Hudson & Manhattan, like the New Haven, was a hopelessly insolvent railroad.

POINT VIII

The Government and Penn Central Failed to Show That 950,000 Shares of Penn Central Stock Plus the Underwriting Have a Value of $83.1 Million. The Shares With the Underwriting Are Not the Cash Equivalent of the Obligation They Are Intended to Discharge.

No effort will be made to deal with the unfair descriptions of the bondholders' position in the Penn Central brief (PC Br. pp. 82-83). The Reorganization Court accurately set forth the position of the bondholders and makes plain the issue on appeal which neither Penn Central nor the Government fairly meet. The Reorganization Court said:

> "The bondholders assert that fairness and equity require that the value should have been based on the market value of December 31, 1966—the valuation

* See Man. Br. p. 81.

> date for everything else—or on the average market for a reasonable period of time before the date of closing. . . . The bondholders claim it is unfair to charge the New Haven's estate with having received $83.1 million when the form in which it was received could be acquired on the open market for about $20,000,000 less." (304 F. Supp. at 809, App. 299a)

Penn Central appears to admit that the market value of the shares if taken at either December 31, 1966 or December 31 1968 plus the value of the underwriting provided by the Courts would be substantially less than $83.1 million (PC Br. p. 95 fn.). Penn Central has not, however, attempted to place a dollar value on the underwriting. Despite Penn Central's reluctance, the computation is not difficult. If the shares are valued at 52⅜—the December 31, 1966 value—the underwriting, *if fully secured,* has a present value of $19,389,611. The overvaluation of the Penn Central shares is then $14 million. If the shares are valued at 63⅜—the closing date value—the underwriting, if fully secured, has a present value of $13,317,420. The overvaluation of the Penn Central shares is then $9.6 million. If this Court agrees that the shares plus the underwriting are not the cash equivalent of $83.1 million to which the New Haven is entitled, it should determine the proper stock valuation date is December 31, 1966, the date for all other valuations.*

The Government and Penn Central argue in effect that the underwriting assures payment in the future of $83.1 million thus eliminating the need for an interest payment. When, however, the Commission considered the value of the New Haven properties, future proceeds were discounted to present value. On the other side of the ledger, Penn Central's 5% bonds, given in payment, were not

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* Manufacturers Hanover and the Committee join in this suggestion to simplify the resolution of this point.

treated at face value but were discounted to their alleged present value. In respect of the New Haven real estate, Penn Central and the Government argue that where a six year liquidation program is assumed, a discount at the rate of 10.5% is appropriate. (PC Br. pp. 55-6; Govt. Br. pp. 53, 58) With respect to the future proceeds of the shares, however, they consider that payment of interest at ½% above the prime rate is somehow unfair. (PC Br. 93-4; Govt. Br. pp. 79-80)*

The assurance that the New Haven will receive $83.1 million by February 1, 1978 is not ironclad. Penn Central properly describes the result of the underwriting formula when it says that the New Haven is a general creditor of Penn Central to the extent of the underwriting. (PC Br. p. 97) It does not explain why, the New Haven's property having passed into the domain of Penn Central, it is inappropriate for the New Haven to be secured, especially when the security requested is not a general mortgage on Penn Central's property but merely a purchase money mortgage on the property transferred. Penn Central itself recognizes that because of the cyclical nature of the railroad business the obligation might be large. Surely the transferor of property should not be left without the right to look at least to the property he has transferred for the satisfaction of the obligation arising out of the fact that only partial payment was made on conveyance.

Penn Central's principal objection to the bondholders' position is that it claims "valuation based solely on market quotation." (PC Br. p. 89) The bondholders see no error in this contention. With respect to all of the New Haven property, market value appraisals were made and dis-

* The Commission required payment of interest from New Haven to Penn Central at the prime rate on loans taken down under the "loan-loss formula." (331 I.C.C. at 711, App. 69a)

counted to present value. It is not unfair to ask the same rules apply to the consideration.

Admittedly, the market price on a given day might be abnormal. Penn Central, however, in its brief (p. 90) shows a range of values from 1962. The shares have been as low as $14, have never attained $87.50,* and are now around $23. The $52⅜ price at December 31, 1966 does not suggest any unfairness to Penn Central especially since those shares were traded in a free, fair and orderly market and it is not contended that the price on that day was artificially and unusually depressed in relation to the price in and around the months of November and December, 1966 and January and February, 1967.

The Government's and Penn Central's reliance (Govt. Br. p. 75; PC Br. p. 85) upon *Group of Investors* v. *Chicago M., S. & P. R.R.*, 318 U.S. 523 (1943) is misplaced. The New Haven reorganization is not the traditional type in which the owners of property continue to be the equitable owners of that property. This case involves the sale of New Haven assets for their cash value. It is, therefore, the cash equivalent value to which the New Haven is entitled even if paid in Penn Central securities.

Penn Central argues that the bondholders now have the best of all possible worlds. (PC Br. pp. 92, 95-6) An analysis, therefore, of the position of the bondholders is in order. No prudent manager of the New Haven may now sell the Penn Central shares for fear the benefits of the underwriting will be lost. Therefore, until the shares reach

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* The majority noted the Penn Central stock had declined "to $63.375 on the dates of the Remand Report and of actual inclusion, and still further thereafter. The decline during the last half of 1968 was the more significant in view of the fact that the Dow-Jones rail average on December 31, 1968, was at approximately the same level as on the date of our decision." (305 F. Supp. at 1064, App. 429a)

$87.50 the bondholders are "locked in" to their position in Penn Central shares. They are at the mercy of Penn Central's dividend policy. They are required to keep their eggs in one basket and cannot diversify. It is said that the down-side protection avoids the risk of loss during the holding period (PC Br. p. 93).* But the bondholders are not asking for interest on that part of the consideration paid to them, but only on the part not paid to them.** Had the bondholders received $83.1 million, the underwriting would never have become necessary.

Penn Central indicates that the bondholders now consider the underwriting so valuable that they no longer ask for the difference between $83.1 million and the values at December 31, 1966. (PC Br. p. 93) Before the Commission, the Reorganization Court and the Statutory District Court, the bondholders asked for that difference. Because of the timing, when the underwriting formula was devised, the Courts and Commission considered it onerous to require payment by Penn Central. The Reorganization Court said:

> ". . . the theory of giving recognition to an intrinsic value in the shares, which will be realized when the full economic benefits of the merger have been achieved, not only assists the Penn Central by relieving it of the need to divest itself of a crippling amount of cash, which would be prejudicial to its merger program, but affords the New Haven an opportunity to participate in probable future profits." (304 F. Supp. at 809, App. 299a)

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* As already noted, this is not true when the claim is not fully secured.

** Since the bondholders seek interest solely on the portion of the $83.1 million obligation not discharged by the value of 950,000 shares at December 31, 1966 plus the value of the underwriting, Penn Central's charge that the bondholders build their claim for interest on the price drop since the closing is without merit. (PC Br. p. 95.)

The Court noted that the New Haven could have purchased the 950,000 shares with $20 million less than $83.1 million on the closing date. (*Id.*) Because the bondholders believe it is appropriate for the courts to take Penn Central's cash needs into account, they seek to correct the formula without depriving Penn Central of the beneficial treatment the courts and Commission felt Penn Central should be accorded. Penn Central carefully avoids volunteering additional shares to make up the difference. The bondholders have asked for such additional shares.*

Penn Central complains that the bondholders erroneously characterized the reviewing courts as having "rejected" the $87.50 valuation (PC Br. p. 88). We do not understand the basis for this criticism. The Reorganization Court said:

> "There is an element of unfairness, however, in the fact that the New Haven has transferred assets conservatively worth what the liquidation value says they are worth. *The purchase price,* to the extent of $83.1 million and fully credited to the purchaser as $83.1 million paid, *is not worth $83.1 million on the present market.* It is credited as $83.1 million paid, on an assurance or assumption that the 950,116 shares will be worth that sum and more, but when and who will make good on that assurance is not known or not stated."
>
> "The nub of the unfairness and inequity is not the 87½ fixed for present calculations, but the fact that the purchaser is getting assets of sure present value while the seller is asked to gamble for its payment on the future of Penn Central." (304 F. Supp. at 809, App. 299a-300a; emphasis added)

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* Man. Han. Br. p. 68; Committee Br. p. 101.

The Reorganization Court contrasted the present value of the New Haven shares with assets which did not have that present worth and sought to redress the balance. Judge Weinfeld considered, on the basis of a similar analysis, that the underwriting was insufficient and voted to remand to the Commission to provide the "equivalent" of $83.1 million (305 F. Supp. at 1069, App. 441a). The bondholders seek only a prompt resolution of the marathon New Haven reorganization proceedings and do not regard a remand as necessary on this point since only a valuation date, an interest rate and approval of the bondholders' right to a purchase money mortgage need be determined by this Court.

Penn Central complains that the order submitted by the bondholders in response to the Reorganization Court's opinion did not ask for interest (PC Br. p. 96). The bondholders considered it inappropriate to submit an order not in conformity with the opinion.

Both the Government (Govt. Br., p. 80) and Penn Central (PC Br., p. 96) complain that a request for interest was not made to the Commission. In fact, however, the Commission entered its Fifth Supplemental Report on July 10, 1969, after the opinions of both courts had been filed and the Reorganization Court did not enter its final order embodying the underwriting until July 28, 1969. The Commission issued its Fifth Supplemental Report without any notice to the parties that it was considering a further Supplemental Report. It held no hearings and it asked for no briefs. Curiously, the Fifth Supplemental Report itself provided:

> "Accordingly, upon entry of a final order by the three-judge court and by the Supreme Court sustaining such order, if an appeal is timely filed, we will entertain written representations from any party regarding the precise terms of an underwriting requirement in order

to enable us to incorporate such a requirement in our decision." (334 I.C.C. at 532, App. 226a)*

The Government is clearly right that in the ordinary course matters should not be presented in this Court which have not been presented to the Commission. The issue respecting the Penn Central shares has twice been before the Commission. The underwriting formula entered the case only in the opinions of the Courts on review of the Remand Report, which reduced somewhat the magnitude of the issue but leaves the central question of the value of the consideration intact. Since the bondholders would accept the difference between the value of 950,000 shares on the valuation date and $83.1 million in shares, refinements to the underwriting are subsumed in the central issue, In this case, however, the Commission would make the appeal ineffective by interjecting reservations of jurisdiction on matters encompassed in the appeal.

Penn Central asserts that the bondholders' interest proposal is inconsistent with the premise of continued ownership of Penn Central stock by the New Haven, arguing, that *if* Penn Central shares achieve expectations "there can have been no loss of the use of capital during the eight-year period— for the expectancy of the bondholders was simply that the Penn Central shares would be held for the life of the investment company." ** (PC Br., p. 94)

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* This was not in accord with the decree of the Statutory District Court, which had provided that the parties were to agree on the terms of the underwriting, and, absent agreement, that the matter was to be determined by the Reorganization Court (App. 452a).

** Penn Central appears to consider that the New Haven received something more than any other stockholder when it received Penn Central shares in that it received an opportunity to share in "upside" gains beyond $87.50 (PC Br. p. 83). Any shareholder who bought Penn shares on December 31, 1966 at 52⅜ received the same opportunity. But the New Haven bondholders were charged $87.50 for this opportunity.

This is a non-sequitur. This was not the expectancy of the bondholders. The Reorganization Court said:

> "These provisions to assure full payment of $87.50 per share are not to be construed by the New Haven or its successor or successors as a directive or limitation on its handling of the Penn Central shares which it owns, either to sell or retain them in whole or in part, and it is intended to leave those responsible for the affairs of the New Haven with the same freedom to exercise their sound judgment in the company's interest, subject to law, as they would have had in the absence of such provisions." (304 F. Supp. at 810, App. 301a)

Another objection of Penn Central is that the bondholders' interest claim has no foundation "since no fixed debt is due or ever has been due—as is evidenced by the difficulty the bondholders have in finding a date to begin the running of interest." (PC Br., p. 94) The bondholders all agree that interest should begin to run from the date of closing. The bondholders have had some differences heretofore with respect to the amount due and owing but not as to the date from which interest should accrue. That date was fixed when the property was delivered and a partial payment was made, leaving to the parties the right to litigate the precise amount of the obligation. The claim for interest based on the difference between the value of the price of Penn Central shares on the valuation date and $87.50 is not offset by the value of the downside protection as argued by Penn Central (PC Br., p. 95). Penn Central may freely elect to pay the unpaid portion of the consideration and be relieved of the underwriting. (App. 319a, 450a)

The Government asserts that the record shows the reorganization plan provides enough cash to service the debt structure of the reorganized company with room to spare,

which assures that the estate will survive until 1978 when the underwriting will mature. (Govt. Br., p. 79) The danger that the New Haven estate will not survive until 1978 is real. The plan requires income each year to meet fixed charges. The following chart (see 334 I.C.C. at 127-28, App. 214a-215a) shows the income required and the dividend rate that would have to be paid on the assumption the 950,000 Penn Central shares were retained throughout:

Year After Confirmation	*Income Required*	*Dividends Needed (Per Share)*
1	$1,734,000	$1.62
2	2,734,000	2.88
3	2,734,000	2.88
4	3,067,000	3.23
5	3,048,000	3.20
6	3,027,000	3.19

There is no assurance these dividends will be paid. To the extent that the underwriting increases the probability that the shares will be retained, the success of the plan depends upon uninterrupted and increasing Penn Central dividends. For this reason, it would have been preferable for the Commission to have provided the cash equivalent of $83.1 million initially. The unsecured underwriting without the interest seriously endangers the plan.

POINT IX

The Government and Penn Central Fail to Justify the Commission's Division of the New Haven Losses Between Penn Central and the New Haven. The Commission's Disposition of These Matters Constitutes Gross Error and Unfairness.*

The Government seeks to excuse the Commission's failure to provide compensation for any part of the New Haven's pre-December 31, 1968 losses by asserting that, "Following the issuance of the inclusion report in 1967, the bondholders in fact took the view that inclusion could not occur except as part of a complete reorganization plan. They therefore did not seek to effectuate 'Step 1' of the trustees' plan by requiring an immediate inclusion of the New Haven, and it was not until the fall of 1968 that all bondholders waived objection to immediate inclusion." (Govt. Br. p. 82)

An analysis of this statement demonstrates that the Commission still contends that upon its issuance of the Inclusion Report containing the *in terrorem* loan-loss formula the bondholders should immediately have surrendered and accepted the terms which both Courts thereafter found substantially inadequate. The Statutory District Court said:

> "The NH bondholders say that . . . the downward progression of Penn Central's percentage constitutes an *in terrorem* provision designed to thwart them from

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* Neither the Government nor Penn Central deal with the point made at pp. 102-09 of the Committee's Initial Brief to this Court that the Commission's failure to provide compensation for the erosion of $70 million of the bondholders' security for the public benefit, except for $5 million of loss contribution, is unfair, inequitable and unconstitutional. The point is addressed on this appeal.

fully presenting their claims to fair treatment. We agree that desire to curtail litigation is an insufficient reason for the downward progression. The Commission should not have assumed that the bondholders' attacks would necessarily lack merit; indeed this opinion shows the contrary. Moreover Penn Central has as much opportunity as the bondholders to prolong litigation. Since the Commission expressly placed the downward slide on this basis, the formula cannot stand, see Justice Douglas' dissent in the Penn-Central Cases, 389 U.S. at 557-558, 88 S.Ct. 602, and we must remand for reconsideration." (289 F. Supp. at 444, App. 366-67a)

Until December 31, 1968, the bondholders were faced with the fact that this Court and the Reorganization Court had already said that the bondholders could not expect the courts to vindicate their rights by Procrustean measures—that is, measures which would deprive New England of rail transportation—although their rights to fair treatment in monetary terms would be defended by the Courts.* The Reorganization Court has pointed out that bondholders have been seeking immediate transfer since 1966.**

The Government fails to recognize that it was the Commission which had the power to require the transfer simultaneously with the merger but declined to do so. It overlooks the fact that the Commission had the power to compel a lease arrangement to commence simultaneously with the merger but declined to do so for the convenience of Penn Central. Only when the Reorganization Court made plain that the invasion of the bondholders' rights had pro-

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* *Penn Central Merger Cases*, 389 U. S. at 510-11; *In re New York, N. H. & H. R.R. Co.*, 281 F. Supp. 65 (D. Conn. 1968), App. 233a-234a.

** 289 F. Supp. at 459, fn. 22, App. 260a.

ceeded so far that the "Procrustean measures" would be taken on December 31, 1968, did the Commission in November of 1968 order the transfer of the New Haven properties to Penn Central so the service could be operated by Penn Central.

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The Government does not seek to excuse the Commission's adherence to a ceiling on Penn Central's loss share after it became aware that its estimates of the extent of the loss were substantially too low.* When this matter was last before this Court, in January, 1968, the Commission handed up the Inclusion Report to show that it had made provision for continued New England rail service by fixing terms for Penn Central's purchase of New Haven assets and by providing a loan-loss formula that would insure the continuation of service. Although the majority of this Court did not consider the question of the loan-loss formula before it, Mr. Justice Douglas dissenting said:

> "The Commission asserted that the burdens on the New Haven creditors caused by the loan loss absorption agreement *would be relatively small—and not significantly different from the burdens under a lease agreement.*" (*Penn-Central Merger Cases,* 389 U. S. at 554-5; emphasis added)

By November of 1968, the Commission knew that the post-merger burdens on the New Haven would not be small. They were at least $11 million. Yet the Commission left the loss-share ceiling unchanged. This was gross error.

The Government attempts to excuse the oppressive erosion imposed on the bondholders on the premise that the

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* Penn Central admits ". . . the Commission was well aware of the alarming increases in the New Haven deficits immediately before the inclusion . . ." (PC Br. p. 91).

bondholders had "invested their capital in a public utility that does owe an obligation to the public.", relying on *Reconstruction Finance Corp.* v. *Denver & Rio Grande Western R.R.*, 328 U.S. 495 (1946). (Govt. Br. p. 82) Even if, arguendo, some erosion is permissible the erosion inflicted in the instant case was unreasonable.*

Penn Central claims that it is excused from bearing a proper share of New Haven losses because it "was not responsible for the delay in inclusion." (PC Br. p. 112) Had Penn Central not thwarted the lease arrangement the burdens would have shifted on the day of merger. It was a condition of the Penn Central merger that Penn Central perform the operations of the New Haven. For this reason, Judge Weinfeld, dissenting each time the matter has been before the three-judge court, said:

> "I concur in the remand except that as to the operating losses of New Haven I would require Penn Central to absorb these from the date of merger to the date of inclusion." (289 F. Supp. at 448, App. 376a)

And he objected to the Commission's formula, declaring:

> "Under this formula Penn Central gains the initial benefits of the merger while creditors assume year-by-year a larger proportion of rapidly-mounting losses of operation, their application for abandonment of passenger service having been viewed as an unlikely eventuality by the Commission 'in view of [its] findings . . . that the services of NH are essential.' ". (289 F. Supp. at 449, App. 378a)

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* The Government recognizes that in that case the creditors were merely required to absorb the costs of capital improvements during reconstruction proceedings. (Govt. Br. pp. 82-3) But the capital improvements added to the value of the estate and did not effect substantial erosion.

The Reorganization Court recognized that the reason the New Haven was not included at the time of the merger was for Penn Central's convenience. (289 F. Supp. at 460-61, App. 248a)

The Government implies a justification for not imposing post-merger losses on Penn Central rests on the absence of Penn Central's control of New Haven operations. (Govt. Br. p. 82) Judge Weinfeld dealt with this argument on the Remand Report review. He said:

> "Consistent with my view previously expressed, the entire interim operating losses should be borne by Penn Central. Its argument that it should not be charged with losses over which it has no control is stripped of much of its force, since it had the opportunity, which it declined for reasons which even the Commission thought unpersuasive, to participate in a joint effort to achieve economies during the interim period." [footnotes omitted] (305 F. Supp. at 1070, App. 442a)

Penn Central's brief refers to the fact that "Penn Central has been required to assume about 60% of the New Haven's losses as computed under the Commission's loss-share formula for the final eleven months of 1968." (PC Br. p. 113 fn. 1) This is misleading. The New Haven absorbed approximately 65% of the New Haven's actual losses for that period. (see Man. Han. Br. p. 85, citing Rec. 326c).

Penn Central argues that since the Reorganization Court decided "that the point at which the New Haven was constitutionally entitled to cease operations was December 31, 1968", Penn Central is not required to absorb the New Haven losses. (PC Br. p. 113) When the Reorganization Court fixed December 31, 1968 as the date when the New Haven's operations must cease on constitutional

grounds it understood that the assets remaining for the creditors would be based on liquidation values at December 31, 1966 on the assumption that an abandonment certificate was then in hand (304 F. Supp. at 798, App. 280a), an anticipation which would be frustrated if the Commission's abandonment delay discounts of $22.1 million were accepted. We urge the imposition of erosion to the magnitude of $70 million in the public interest is condemnation by regulation. The Reorganization Court's rejection of the abandonment delay discounts does not cure this defect.

The history of this case reveals that the creditors have, at least since December 1963, been required to subsidize the public need for transportation in New England. One of the main justifications for the Penn Central merger, which benefits Penn Central to the extent of nearly a billion dollars, was its undertaking to operate the New Haven service. This Court has said that gross error and unfairness may be corrected on review. *Penn Central Merger Cases, supra,* at 524. Such gross error and unfairness is dramatically presented by the imposed erosion and the division of the post-merger losses in the instant case.

CONCLUSION

As we have pointed out in this and earlier briefs, the Commission acted throughout this case on the premise that the public interest in the preservation of railroad service in New England overrode the rights of the New Haven bondholders. It also acted upon the further conviction that Penn Central, as the surviving transportation system, should be burdened as little as it conceived to be possible. To accomplish this end, the bondholders have been denied any meaningful option except to continue operations at enormous losses until Penn Central was

ready to assume the obligations it freely accepted in order to achieve its merger. Now the Commission has sought to increase the bondholders' burdens by developing a liquidation value which it has conceded is "conservative" and then reducing the liquidation value allegedly in the interest of "fairness" to Penn Central.

Penn Central asserts that where the statutory plan requires the Commission to consider the public interest, and the agency takes the public interest into account, the Courts should give agency findings their ordinary respect. (PC Br. p. 24) The bondholders do not disagree with Penn Central's statement. They disagree with the applicability of that principle to the instant case where the history set forth in the bondholders' briefs demonstrates that the Commission's overly intense concern for the surviving transportation system dominated its findings and conclusions. Penn Central's position is tantamount to the assertion that whenever an administrative agency must consider the public interest, the Courts will be precluded from declaring that the public interest has been overprotected at the expense of the private interest. It assumes an unlimited range of flexibility. This principle, it is submitted, would eliminate the constitutional due process to which parties before administrative agencies are entitled. It is indefensible and explains why the briefs of Penn Central and the G[illegible]ment do not deal with *Atlantic Coast Line R. R.* v. *St. Joe Paper Company*, 179 F.2d 538 (5th Cir. 1950), *cert. denied*, 339 U.S. 929 (1950), which is discussed in the Committee's Brief at pp. 46-47.

The Commission's result imposes permanently a portion of the future deficits from the New Haven operations upon the bondholders, effectively denying both the right to liquidation and the fair value equivalent of that right, which

the Constitution commands and the Commission purports to have recognized.

For all of the foregoing reasons, this Court should reverse the decree of the Statutory District Court and remand it for modification in accordance with the points set forth in this brief and our preceding briefs. The order of the Reorganization Court should be reversed and remanded for similar modification.

Respectfully submitted,

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